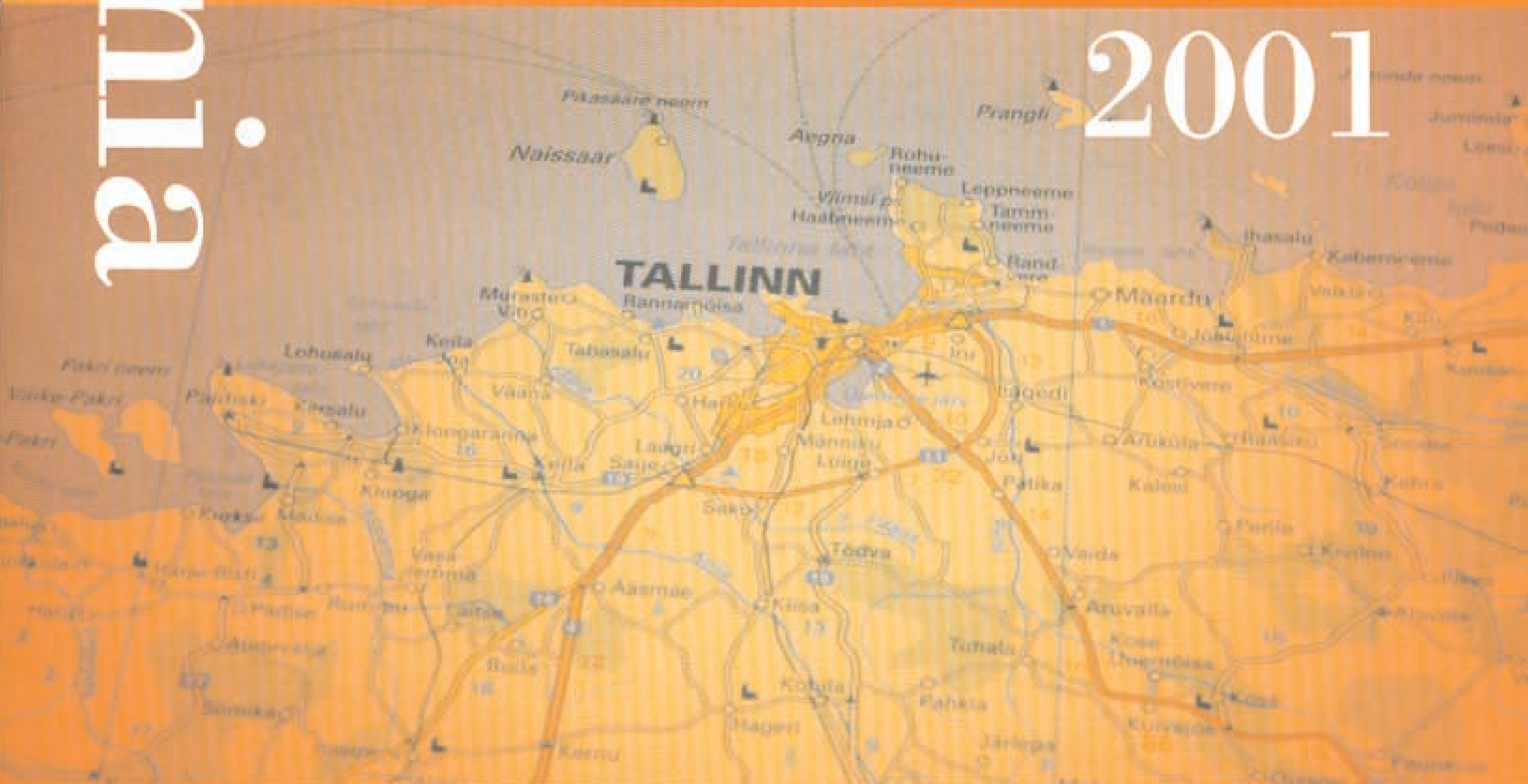
Estonia

BUSINESS FORUM
LONDON 22-24 APRIL 2001

Investment Profile 2001



Held on the occasion of the EBRD ANNUAL MEETING

Contents

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Foreword

Estonia is considered to be one of the most advanced transition economies in central and eastern Europe. Ever since regaining independence in 1991, Estonia has set out to build an open, free market economy. The cornerstones of its economic success – a balanced state budget, a stable currency pegged to the Deutschemark and liberal trade and investment laws – have been faithfully adhered to by successive governments.

The country has achieved a high level of commercial and financial integration with the European and global economy. Foreign economic relations have served as an engine for the development of Estonia's small and open economy. The economic growth of over 5 per cent on average since 1995 has to a great extent been based on the rapid growth of exports and a high level of investments. More than eight years of macroeconomic stability based on the strong convertible currency, the kroon (EEK), has helped attract substantial foreign direct investment. Complemented by a related transfer of technology, progress has been made in moving up the value-added chain, and trade has been reoriented away from the volatile markets of the CIS towards the west.

Estonia has an extremely favourable investment climate. The legal framework for private enterprises is largely in conformity with the EU and is further harmonised for EU accession. There are no exchange controls or restrictions on foreign investment. In addition to the favourable tax policy the government will continue with equal treatment of foreign and domestic investors and further support the business climate through economic policies to retain the openness, competitiveness and attractiveness of the economy.

The overall objective of Estonia's short and medium-term economic policy as outlined in the Economic Development Plan for 1999-2003 is to achieve sustainable and socially and regionally balanced economic growth. To that end, Estonia will be continuing with a number of key long-term reforms, notably of public finances and administration, the pension system, as well as with further restructuring and privatisation of the few remaining large infrastructure companies where state participation is still dominant. Over the medium term, these measures will further strengthen the working of market forces, improve resource allocation and contribute to private sector confidence.

Monetary policy will remain focused on ensuring long-term price stability. Estonia will maintain the current monetary framework, i.e. the currency board arrangement and the peg of its currency to the Deutschemark (and hence to the euro). This will support Estonia's ultimate goal of joining the European Economic and Monetary Union. Stability-oriented macroeconomic policies and a business-friendly environment will continue to attract foreign capital inflows, mainly foreign direct investment, which will promote structural changes, increase the competitiveness of businesses and further stimulate export reorientation to European markets.

The sound economic policies, stable banking sector, price stability and growing integration with Scandinavian and other western markets and the successful completion of first generation structural reforms will make the Estonian economy well positioned for a new take-off of economic growth. This in its turn will provide a good basis for Estonia to become one of the first transition countries to become a member of the European Union.

Ministry of Finance of Estonia

Introduction

Estonia is one of the most advanced transition countries in central and eastern Europe and started negotiations for EU accession in 1998, which are currently progressing well. Ever since restoring independence, reform-minded governments have energetically implemented comprehensive reforms, creating one of the most consistently open-market-oriented economies and favourable investment climates in eastern Europe. As a result, Estonia has attracted among the highest rates of foreign direct investment per capita in the region. Estonia actively pursues regional cooperation with the other Baltic and Nordic countries and has enjoyed considerable investment from the latter. The country is an important transit hub for trade between the CIS and the EU. Relations with Russia have improved, while EU membership is now within sight.

Estonia restored independence in 1991. From the onset of its transition, the country vigorously sought a place at the EU accession table. Estonia has consistently embraced market reforms and has made remarkable progress in the transition to a market economy. The country introduced price and trade liberalisation, small and large-scale privatisation and financial sector reform at an early stage and in a most consistent way. As a result, the economy has grown by an annual average of more than 5 per cent since 1995. Over eight years of macroeconomic stability based on a strong convertible currency, the kroon (EEK), has helped attract substantial foreign direct investment (FDI), at first mainly from neighbouring Finland, followed by Sweden, Denmark, other EU countries and the US. Estonia managed to attract among the highest volumes of FDI in the region on a per capita basis. Privatisation of state assets, in particular in the energy and railway sectors, restructuring and consolidation in the financial sector as well as important reforms in the area of pensions and in the fiscal sphere have strengthened the base for the continuation of strong growth.

Challenges met and challenges ahead

With the privatisation of most medium-sized and large industrial enterprises complete, one of the reform challenges in 2000 was the restructuring and privatisation of some of the remaining state infrastructure enterprises. This challenge has been met with majority shares in the water utility and the national railway companies and a 49 per cent stake in the country's largest power generation plant sold or in the final stage of being sold to strategic investors. A new telecommunications law in line with EU directives opened the fixed-line telephone market to competition from January 2001. Approval of this early liberalisation date placed Estonia among the first east European countries to open up all segments of its telecoms market. The remaining state-owned 27 per cent stake in the national telephone incumbent is likely to be sold in the second half of 2001.

In addition, the Estonian banking sector has strengthened considerably over the past years. Following a number of mergers and bankruptcies, seven licensed banks are now operating. In June 2000, the Bank of Estonia (the central bank) reached an agreement with Sampo Finance (Finland) for the sale of its 58 per cent stake in Optiva Bank, the third largest bank in Estonia and the last commercial bank in which the state had an ownership interest. As a result, the three largest banks, controlling more than 90 per cent of total assets, are now all foreign-owned. The provision of the banking services and the investment services are highly interrelated: the main providers of investment services in Estonia are the credit institutions. As for the insurance market, companies that are majority owned by non-residents control 72 per cent of the non-life insurance market. Bank subsidiaries are the market leaders in life insurance with 67 per cent. Plans are underway to establish an integrated financial supervisory authority for banking, securities and insurance which will become operational from 1 January 2002 and which will have operational and financial independence according to international best practice. To that end, the key target regarding the administrative capacity in 2001 is the organisational strengthening of the supervisory institutions, particularly the Securities Inspectorate, which has long been considered to be the weakest link in the chain of financial market supervisors, in order to ensure the necessary basis for the establishment of the new unified financial supervisory authority.

Another challenge ahead is the introduction of the fully funded second pillar for pensions and an increase in the retirement age to address the demographic shift and ensure the sustainability of the pension system. The authorities are moving from the pay-as-you-go pension system to a three-tier partially funded scheme. The first tier became operational in January 1999. The third tier, introduced in July 1998, consists of voluntary contributions administered by private pension funds and insurance companies. The fully funded second tier will offer additional pension coverage financed by individual contributions. The second pillar shall be mandatory for all contributors from the age of 18 and for those who have once choosen to join it there is no option to switch back. The collection of contributions to the second pillar will start in 1 January 2002.

A very important issue for the government is the creation of more evenly spread regional diversion. The Tallinn area has been and is still the region attracting most investments and generating most of the country's GDP. The government aims at better regional diversification and is working hard to divert economic activity and finance from the Tallinn region to the less developed regions. Development of the Narva region is a particular focus of attention, since it has the highest unemployment rate, which is about double the national average. Estonia's economic policy, outlined in the National Development Plan and the Economic Development Plan, is to achieve sustainable and socially and regionally balanced economic growth by improving competitiveness and entrepreneurship, human resources and infrastructure.

Another area for attention is to increase the level of domestic savings, which is not deemed sufficient to finance the investment needed for sustainable development of the economy. The policy is geared towards completing the transition process with further improvements to the functioning of the market economy to decrease development gaps between Estonia and the EU and so to become a viable participant on the EU market.

International relations

The two main goals of Estonian foreign policy are membership of NATO and of the EU. Estonia is participating in NATO's Membership Action Plan to be better prepared for eventual future membership. The government is also working with its neighbours and supporting states on Baltic Defence Projects, and plans to increase its defence budget to 2 per cent of GDP before the crucial 2002 Alliance Summit. Estonia is confident that Russia's opposition will not block NATO enlargement.

Relations with Russia, which have been strained since independence, have improved in recent years. As a major trade bridge between the west and the CIS, Estonia is aware that its future lies in amicable and strong relations with Russia. Estonia and Russia are focusing in their bilateral relations on the resolution of practical questions and on preparing for concrete agreements in the economic, social and cultural fields. In order to increase the efficiency of this work, an Intergovernmental Commission co-chaired by the Estonian Prime Minister and the Russian Deputy Prime Minister was formed in 1998. Normalisation of bilateral relations requires the signing and ratification of a border treaty between Russia and Estonia. In March 1999 the two sides reached a significant breakthrough when the heads of the negotiating teams initialled a treaty that retains the border as defined in 1991 except for an exchange of some 30 square kilometres of land. The sea and land borders have been confirmed by domestic legislation in both countries, each of which recognises them. Border guards patrol the border in accordance with the state border regime. Another key issue has been the situation of the Russian minority, which accounts for about one third of the population. However, according to the opinion of international organisations, Estonia has fulfilled all its commitments regarding minorities. Russia continues to impose discriminatory import duties. This issue will be addressed in Russia's negotiations for WTO membership.

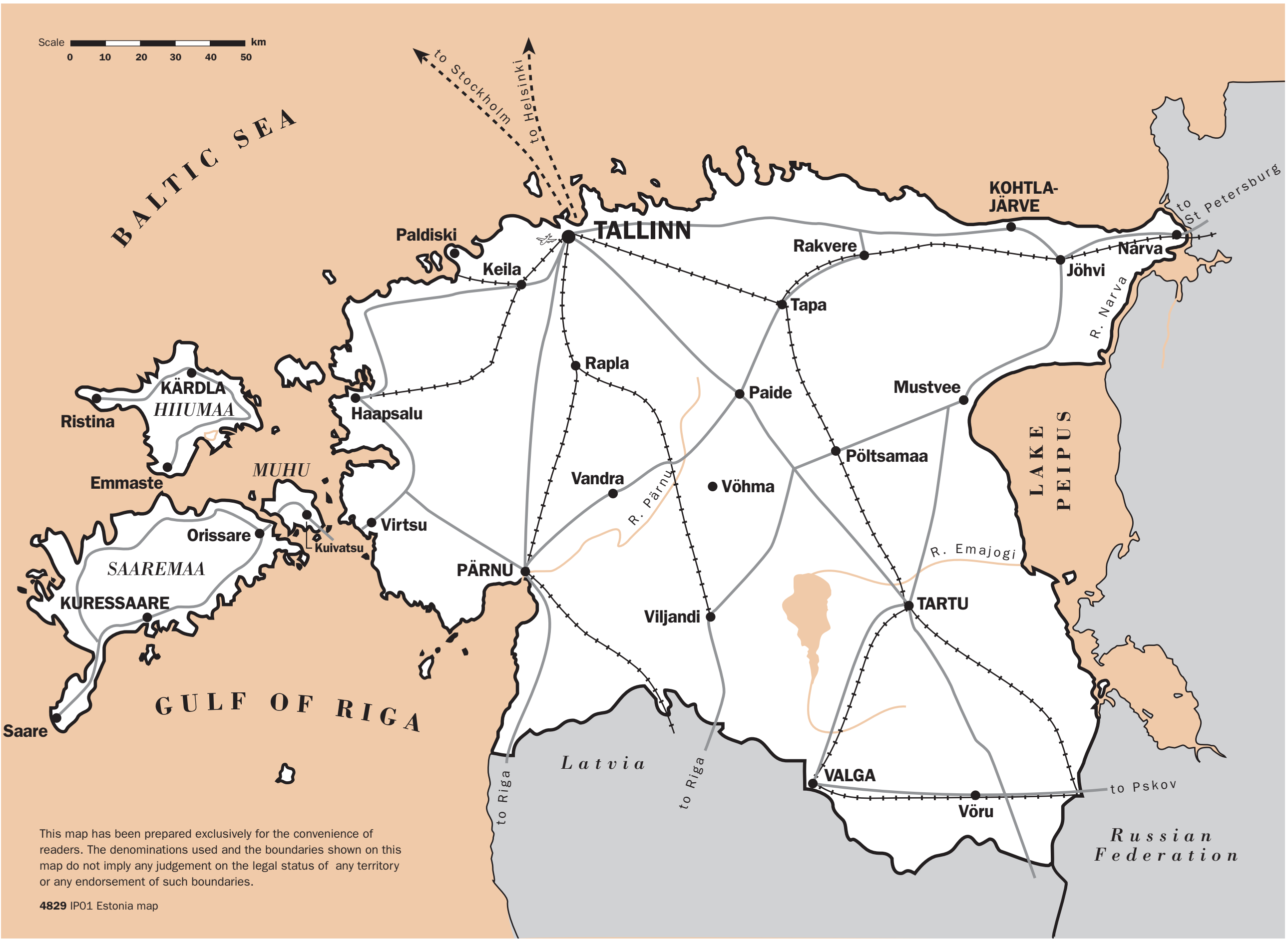
EU accession prospects

Estonia was one of five east European countries recommended by the European Commission in July 1997 to start talks on EU entry in early 1998. Estonia's chances of being in the first wave of new EU members have been strengthened by the Commission's most recent Progress Report of November 2000. Most of the criticism in the report was directed at non-economic issues (the main sticking point to accession is likely to be the environment), thus signalling that Estonia meets most of the economic criteria for accession, although not all have been satisfied yet. The centre-right coalition which came to power in March 2000, led by prime minister Mart Laar, is highly commended for its economic policies.

The report confirms that Estonia remains among the frontrunners for EU enlargement. By the end of January 2001 agreement had been reached on 16 of the 31 policy chapters under negotiation – a score rivalled only by Cyprus. Estonia has long since fulfilled the first economic accession criteria – that of having a "functioning market economy" – and is very close to the second one: being able to withstand competition in the single European market. The report states that Estonia has pursued liberal economic policies ever since independence, and confirms that the legal environment is in harmony with EU regulations in those areas where the EU mandates the absence of state interference, such as the financial sector or in the case of subsidies to industry.

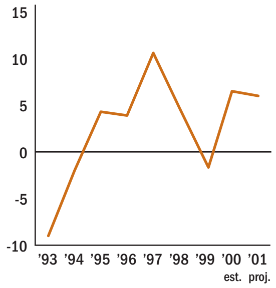
However, Estonia fares less well in areas where EU law requires active state involvement. The main problem areas highlighted by the report concern public expenditure management and debt policy, reforms of the pension and health care systems, reforms in the energy sector, and land reform. The Commission is worried about the size of the current account deficit and it wants to see further fiscal consolidation. For that, the government is advised to keep a lid on local government expenditure and to reinforce the tax administration.

With sound economic policies and robust GDP growth projected for the short and medium term, Estonia is firmly on track for EU accession. The government is confident of meeting the pre-accession requirements by 2003, although actual entry to the EU may be delayed by a few years depending on the readiness of the EU itself to accept new members. Estonia's early accession will be a reward for the consistent reform policies successive governments have implemented ever since the onset of the country's transition.

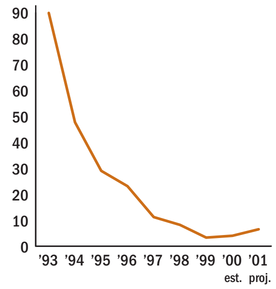


Economic summary

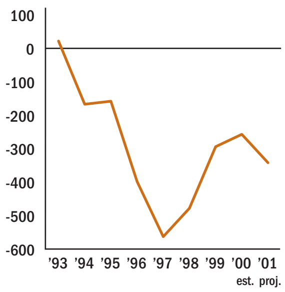
GDP at constant prices
% change



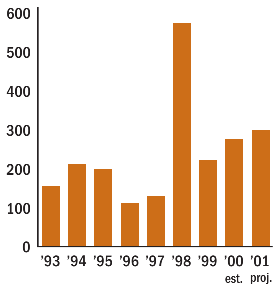
Consumer prices
Annual average, % change



Current account
US$ millions



Total FDI
US$ millions, cash receipts, net



Source: EBRD, January 2001

Estonia has recorded robust GDP growth in 2000, estimated at 6.5 per cent. The economy has grown by an average of close to 5 per cent every year since 1995 and attracts FDI volumes among the highest in the region on a per capita basis. There was also a significant fiscal correction in 2000 on the back of renewed economic growth and a strict containment of expenditures. Furthermore, the current account deficit narrowed to 4.1 per cent in the third quarter of 2000, compared to 5.7 per cent for 1999 as a whole. It is likely that the currency board will remain in place until full EMU membership, not expected until at least two years after EU accession. Estonia is firmly on track for EU accession, which is likely to result in further high levels of FDI inflows and thus continue to spur vigorous economic growth in 2001.

GDP

Following negative growth of 1.1 per cent in 1999 in the aftermath of the Russian financial crisis, the economy is estimated to have grown by an impressive 6.5 per cent. This strong growth was driven mainly by a sharp increase in exports and by a recovery in private domestic demand. Growth in 2001 will continue to be export-led, although export growth is likely to slow down somewhat from its brisk pace in 2000 given a likely deterioration in the external environment. In the absence of any exogenous shock, the economy is likely to grow by 6 per cent in 2001 and 5-6 per cent over the medium term as preparations for EU accession advance.

Inflation

As a result of the large increase in the oil price and the weakness of the euro (to which the kroon is pegged), 12-month CPI inflation reached 5 per cent in December 2000, against 3.8 per cent in December 1999. The annual average inflation in 2000 was 4 per cent, compared to 3.3 per cent in the previous year. For 2001 an end-year inflation figure of 6.4 per cent and an annual average inflation figure of 6.5 per cent are projected. The Estonian authorities project a somewhat lower annual inflation in the range of 4-5 per cent as the forces that drove inflation in 2000 have diminished, such as the weakening of the euro and the increase of oil prices.

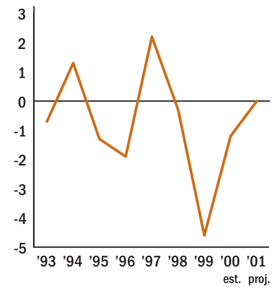
Current account

The current account deficit narrowed to 4.1 per cent in the third quarter of 2000, compared to 5.7 per cent for 1999 as a whole. Foreign direct investment (FDI) covers around 70 per cent of the current account deficit, while most external borrowing is medium- to long-term, dominated by private sector borrowing. The debt service ratio is low because of strong non-debt creating inflows and the increase in the net foreign assets of the banking system. The current account deficit in 2001 is projected to amount to 6.2 per cent of GDP.

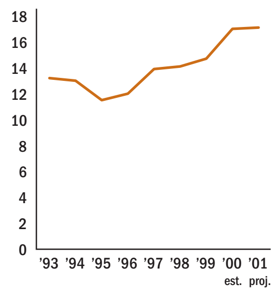
FDI

Net FDI inflows in 2000 are estimated at US$ 277 million. This figure is higher than in 1999 (US$ 222 million), due to acquisitions in the banking sector and a better global investment climate in general. Only 1998 recorded higher inflows, but FDI in that year was unusually high due to the entry of two large Swedish banks into the Estonian market. Excluding these, 2000 set record FDI and exceeded the government target of 5.6 per cent of GDP. Cumulative net FDI inflows from 1993 amounted to almost US$ 1.9 billion by the end of 2000. Cumulative FDI inflows per capita are among the highest in the region. With EU accession negotiations ongoing, FDI inflows are expected to increase to US$ 300 million in 2001. Privatisation revenues in 2001 are likely to be substantial due to the sale of infrastructure and utility companies.

General government balance
% of GDP



Exchange rate
Annual average, kroon per US$



Source: EBRD, January 2001

Government balance

Following the high fiscal deficit of 4.7 per cent of GDP in 1999, a sharp fiscal correction ensued in 2000 and the fiscal deficit amounted to 0.72 per cent of GDP, well within the IMF target of 1.25 per cent, on the back of renewed economic growth and a strict containment of expenditures. The budget that has been approved for 2001 is balanced. On the revenue side, the budget anticipates a significant reduction in the ratio of direct taxes to GDP. On the expenditure side the budget envisages a continuation of the freeze of nominal pensions and government wages following the excessive increases awarded in 1999, with the exception of salaries of teachers and cultural workers. Starting from 2002 pensions will be indexed, depending on the change in the CPI and the social tax fund.

Exchange rate

Since 1992 Estonia has been operating under a currency board arrangement. From 1 January 1999 the Bank of Estonia set the exchange rate of the kroon against the euro at EEK 15.6466, equivalent to the previous fixed exchange rate of EEK 8 to the Deutschemark. Under EU rules, a country must be a member of the 15-nation bloc and its exchange rate mechanism (ERM) for two years before adopting the single currency. The European Central Bank has agreed that a currency board system based on the euro could be used as transition to full EMU membership in ERM II. As a result of this decision, there is now stronger likelihood than ever that the currency board will remain in place until full EMU membership.

EU accession

The government is confident in meeting EU pre-accession requirements by 2003, although the actual entry to the EU may be somewhat later depending on the readiness of the EU itself to accept new members. The main problem areas highlighted by the EU in its most recent Progress Report in November 2000 concern reforms of public expenditure management and debt policy, reforms of the pension and health care systems, and reforms in the energy sector and land. The main sticking point to accession is likely to be the environment. (See *Introduction*.)

IMF agreements

In March 2000 the IMF approved an SDR 29.34 million (approximately US$ 37.8 million) precautionary Stand-by Arrangement (SBA) for Estonia. The main objective of the programme was a reduction in the budget deficit to around 1.25 per cent of GDP in 2000 from 4.8 per cent in 1999. Key components of the structural reform agenda under the programme are the privatisation and restructuring of the remaining state-owned infrastructure companies, improved supervision in the financial sector, reform of public administration, and reform in the pension and health areas. A positive IMF assessment in its second review of Estonia's performance under the SBA was published at the beginning of January 2001. This opened the way for the release of a further SDR 4.2 million (approximately US$ 5.5 million) of the SBA, which the authorities are not expected to request as they have regarded SBAs as precautionary for a number of years already.

Credit ratings

Standard & Poor's

Local Currency			Foreign currency		
Long-term	Outlook	Short-term rating	Long-term rating	Outlook	Short-term
A-	Positive	A-2	BBB+	Positive	A-2

Moody's

Bonds and notes		Bank deposits	
Long-term	Short-term	Long-term	Short-term
Baa1	P-2	Baa1	P-2

Fitch IBCA

Long-term	Short-term
F2	BBB+

Selected economic indicators

	1993	1994	1995	1996	1997	1998	1999	2000 est.	2001 proj.
GDP (% change)	-9.0	-2.0	4.3	3.9	10.6	4.7	-1.1	6.5	6.0
Consumer prices (annual average % change)	89.8	47.7	29.0	23.1	11.2	8.2	3.3	4.0	6.5
Current account (in US$ millions)	22	-167	-158	-398	-563	-478	-294	-257	-342
General government balance (% of GDP)	-0.7	1.3	-1.3	-1.9	2.2	-0.3	-4.6	-1.2	0.0
Trade balance (in US$ millions)	-145	-357	-666	-1,019	-1,125	-1,115	-887	-680	-782
Total FDI (in US$ millions, cash receipts, net)	156	212	199	111	130	574	222	277	300
External debt stock (US$ millions)	298	534	785	1,387	2,562	2,924	2,879	2,937	3,050
Unemployment (% of labour force)	6.6	7.6	9.8	10.0	9.7	9.9	12.3	12.8	na
Exchange rate, annual average, kroons per US$	13.2	13.0	11.5	12.0	13.9	14.1	14.7	17.0	17.1
Gross reserves, excluding gold (end-year, US$ millions)	388	511	650	703	821	876	944	1,031	1,299

Source: EBRD, January 2001

Investment climate

Estonia has one of the most favourable investment climates and consistently open-market-oriented economies in eastern Europe, and attracts one of the highest levels of FDI per capita in the region. The country's rapid progress towards EU accession is likely to continue to result in high levels of FDI flowing into the country. Foreign investors do not encounter any major obstacles in conducting business. With the abolition since January 2000 of taxation on corporate profits reinvested in Estonia, the country became even more attractive for foreign enterprises. Legislation is compatible with OECD countries and is being further streamlined in accordance with EU directives. Estonia has eliminated tariff and non-tariff barriers to trade and has been a WTO member since 1999. Domestic investment as a share of GDP has been close to 30 per cent since 1994.

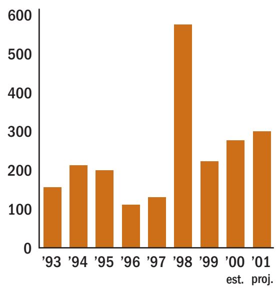
Foreign direct investment

In 2000, total net FDI was estimated at US$ 277 million, according to preliminary EBRD estimates. This figure is higher than in 1999 (US$ 222 million), due to acquisitions in the banking sector and a better global investment climate in general. Excluding 1998, when FDI was swelled by the entry onto the Estonian market of two large Swedish banks, the 2000 FDI total is a record high and reflects the favourable business climate.

FDI exceeded the government target of 6.5 per cent of GDP. The size of investment income in 2001 will depend on the successful completion of the privatisations in the railway and energy sectors and on an investment to be made by Ruma Estonia in a steel terminal at Muuga Port. (See *Major sectors of the economy: Transport* below.)

According to preliminary EBRD estimates, cumulative net FDI inflows from 1993 amounted to US$ 1.881 billion by the end of 2000. The largest investments have been made in the transport, communications, manufacturing, finance and trade sectors. By the end of 2000, direct investments formed almost half of all foreign investments made in Estonia.

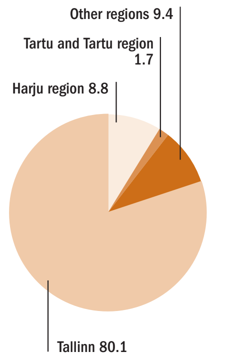
Total FDI
US$ millions, cash receipts, net



Source: EBRD, January 2001

As usual, the main sources of net FDI in 2000 were the Nordic countries. Finland and Sweden were number one and two by far, followed by Germany, the US, and the UK. As in other years, most FDI was made into the Tallinn region. Regional development to spread investment more

Regional share of FDI stock
percentage of total



Source: Bank of Estonia, February 2001

Top 10 sources of cumulative investment, as at 30 September 2000

Country	% of total
Sweden	39.2
Finland	31.1
USA	4.5
Norway	4.3
Denmark	4.1
Germany	2.7
UK	2.6
Netherlands	2.1
Russia	1.4
Others	6.7

Biggest investments in 2000

Investing company	Country	Investment	Sector/activity
Sampo	Finland	Optiva Pank	Banking
Linstow International	Norway	Reval Hotelligrupp	Hotels
Telediffusion de France	France	Estonian Broadcasting Transmission Centre	Broadcasting
Kotkan Energy	Finland	Heating companies	Energy
Elcoteq	Finland	Elcoteq Tallinn	Electronics

Source: Bank of Estonia, January 2001

evenly throughout country is a government priority (see *Investment policy* below). The sector attracting most net FDI in the first three quarters of 2000 was the financial sector, which received more than half of the total, followed by manufacturing and (wholesale and retail) trade.

A considerable inflow of budget revenues in 2001 is likely to come from large-scale privatisations, especially in the utilities and infrastructure sectors as the privatisations of the Narva electric power stations, Tallinn Water, and the railway company Eesti Raudtee are to be completed this year (see *Privatisation and restructuring and Major sectors of the economy* below).

Investment policy and incentives

Estonia has one of the most favourable investment climates in central and eastern Europe. All successive transition governments have had a very liberal and open attitude towards foreign investors. There is a full legal framework in place for private enterprises, which is largely in conformity with the EU and is being further harmonised with EU legislation. The only capital transactions for which some restrictions still apply are investments in real estate by non-residents.

Investments are permitted in all areas of industry, including some utilities, and all foreign investment ventures are granted national treatment. The Foreign Investments Act, under which the government could specify areas of activity where the establishment of enterprises with foreign capital or participation of foreign investors could be prohibited or could only take place under licence, was entirely revoked in July 2000. There are no restrictions on property rights and repatriation of profits.

There are no specific tax holidays for foreign investors. Corporate tax on reinvested profits was abolished as from 1 January 2000, which has made the investment climate even more favourable. As preferential treatment is not compatible with EU membership, special tax free zones are being phased out. Free zones at Muuga Port, Sillamäe, Valga and Võru were created before Estonia's application to join the EU. In 2000 the government decided to close Võru free zone. The government does, however, aim at better regional diversification and is working hard to divert economic activity and finance from the Tallinn region to the less developed regions. Development of the Narva region is a particular focus of attention.

Investors do not encounter any major obstacles in conducting business in Estonia. Transparency International's Corruption Perception Index for 1999 listed Estonia 27th among 99 surveyed countries, the second best score for transition countries after Slovenia. Some investors have mentioned excessive bureaucracy and a mild degree of bribery as negative factors. However, within the process of government reform bureaucracy is being further reduced and bribery is dealt with in the most rigid way.

In January 2000, parliament approved changes to the Securities Market Act, the Investments Funds Act and the Criminal Code, designed to protect minority shareholders and improve transparency in takeovers. The new Securities Market Act will bring regulations in line with EU and international

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The Estonian Investment Agency (EIA) was established in 1994 to develop the national economy by promoting FDI into the country. Together with the Estonian Trade Promotion Agency, the Estonian Regional Development Agency, the Estonian Technology Agency and the Estonian Tourism Board, the EIA forms a part of Enterprise Estonia. (Enterprise Estonia (EAS) was established by the Ministry of Economic Affairs in 2000 and is financed from the state budget. The activity of EAS is focused on achieving joint targets by the owner (state) and the customers (enterprises). The mission of Enterprise Estonia is to support Estonian enterprises by applying approved and effective public measures.) The EIA provides information to companies to help them evaluate the opportunities for investment in Estonia. It has two regional offices in Estonia and foreign offices in Germany and the UK. The EIA provides:

- general and industry-specific information on investment opportunities in Estonia;
- an introduction to useful contacts in the public and private sectors;
- identification of potential co-operation and joint venture partners;
- help in organising visits to Estonia; and
- location of industrial and business property.

The Estonian government has accepted a number of proposals put forward by the EIA on behalf of foreign businesses. The agency also maintains regular contact with existing investors to advise them on plans for further expansion and to trouble-shoot.
A range of publications is available to companies and business people on request.

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standards, and is scheduled to take effect on 1 July 2001. (see *Financial sector* below).

Following the Money Laundering Prevention Act, which was approved by parliament in November 1998, took effect in July 1999 and was amended in October 2000, the Money Laundering Information Office (FIU) was established under the Police Board in July 1999. An amendment to the Law on Taxation, which took effect from 17 November 2000, stipulates that the tax authorities can provide the FIU with information relating to taxpayers and withholding agents if the information is necessary to avoid, discover or investigate money laundering or related criminal activities. A separate law, effective from 1 April 2001, gives the authorities the power to provide information relating to taxpayers to the Public Procurement Office.

A bill has been approved aimed at improving the efficiency of the judiciary. The law will bring the court system into line with EU norms by allowing for regular checks of judges' competency, as well as increasing their remuneration and more closely defining the authority of the justice ministry and state courts.

The Competition Act, modelled on EU legislation, was passed in March 1999 and later amended to introduce a merger clearance regime. The implementation of the law is broadly effective. The national competition authority is the Estonian Competition Board. The act requires the competition agency to investigate mergers to ascertain their impact on competition. The act also provides for limits on enterprises that have exclusive rights or natural monopolies and establishes criteria for the granting of state aid.

Privatisation and restructuring

Privatisation of state-owned industrial enterprises is virtually complete. The private sector contribution to GDP is now estimated to be above 75 per cent. The focus in 2000 was on the restructuring and privatisation of some of the remaining state transport and utility enterprises. The State Privatisation Programme for 2000 should have been the last privatisation programme. Apart from several infrastructure and utility companies, the programme included a hotel complex in Tallinn, a regional airport (Tartu) and a broadcasting company. The sale of Tartu Airport fell through at the end of 2000.

After almost four years of negotiations, in August 2000 the Estonian government fixed the conditions for the sale of a 49 per cent stake in Narva Elektrijaamad (Narva Power) to NRG Energy Inc. (US) for US$ 70.5 million. Eesti Energia (Estonian Energy) and NRG Energy signed an agreement on principal terms relating to Narva Power. State-owned Eesti Energia retained the remaining 51 per cent. NRG Energy has committed to invest around US$ 300 million in the power stations over the coming years. (See *Major sectors of the economy: Energy* below).

In December, the preferred bidder was declared in a tender for the sale of a 66 per cent stake in Eesti Raudtee, the largest rail freight operator. In January 2001, however, the sale was suspended by a legal challenge from one of the other bidders.

An agreement on the sale of a 100 per cent stake in Edelaraudtee, the largest passenger service, to GB Railways Group (UK) was signed at the end of November. GB Railways paid EEK 10 million (US$ 540,000) for the shares and increased the company's stock capital by EEK 100 million (US$ 5.4 million). (See *Major sectors of the economy: Transport* below.)

In June 2000, Sampo Finance (Finland) bought a 58 per cent stake in Optiva Pank, the third largest bank in Estonia and the last commercial bank in which the state had an ownership interest. In addition, Sampo purchased the rest of Optiva shares owned by minority shareholders and managed to acquire a total of 93.5 per cent of shares. Optiva Pank was renamed Sampo Pank from 1 January 2001 (see *Financial sector* below).

Telediffusion de France became 49 per cent shareholder in the Estonian Broadcasting Transmission Centre Ltd (Ringhaalingu Saatekeskus) and paid EEK 95.4 million (US$ 5.26 million) in early November 2000 and pledged to invest EEK 282 million (US$ 15 million) over three years.

In early 2001, a 50.4 per cent stake in water utility Tallinna Vesi (Tallinn Water) was sold to International Water and United Utilities (both UK) for US$ 78.2 million (see case study below).

A plan to sell the remaining 27 per cent stake in Eesti Telekom was delayed until the second half of 2001, to await the effects of the market liberalisation and given current unfavourable market conditions (see *Major sectors of the economy: Telecommunications* below).

Markets and trade

Since the Russian financial crisis of 1998, there has been a sharp reorientation towards western markets, which is still under way, especially to Finland and Sweden, Estonia's main trading partners both in export and import terms. Latvia and

Lithuania were also among the top 10 export markets for Estonian products in 2000. Estonia exported mostly machinery and equipment, timber products and textiles, while it mostly imported machinery and equipment, chemical products and textiles.

Estonia is essentially a duty-free country with few non-tariff barriers. Estonia became a member of the WTO in November 1999. Under the accession agreement, the country accepted the obligations of all WTO multilateral agreements without transition periods. It committed itself not to raise import duties on goods above maximum levels that range for most industrial products between 0-10 per cent, and for most agricultural products between 15-45 per cent. In services, Estonia agreed that by 2003 it would open its telecommunications market to foreign providers of long-distance and international services in the fixed-line sector (which it has already done from 1 January 2001), and give free access to foreign providers of financial, freight, educational, environmental and tourist services. Most of these requirements have already been met.

The country, which has not applied tariffs since the mid-1990s, endorsed a customs bill in July 1999 that created a general framework for the application of customs duties in preparation for EU accession. From January 2000 Estonia introduced new customs duties on agricultural goods from non-EU countries

Main export commodities in 2000, per cent

Export	%
Machinery and equipment	38.5
Timber, paper (products)	15.8
Clothing, footwear, headgear	13.2
Metals and metal products	6.9
Food products	6.8
Furniture etc.	6.6
Chemical products	5.9
Transport vehicles	2.5
Mineral products	2.3
Other	3.4

Main import commodities in 2000, per cent

Import	%
Machinery and equipment	38.5
Chemical products	11.5
Clothing, footwear, headgear	9.5
Food products	8.6
Metals and metal products	8.1
Transport vehicles	6.9
Mineral products	6.1
Timber, paper (products)	4.8
Furniture etc.	2.3
Other	4.0

Major trading partners in 2000

Country	Exports, %	Country	Imports, %
Finland	31.3	Finland	37.2
Sweden	19.8	Sweden	10.6
Germany	8.2	Germany	9.5
Latvia	6.8	Russia	8.1
UK	4.2	Latvia	3.9
Denmark	3.3	Netherlands	3.1
Lithuania	2.7	Denmark	3.0
Netherlands	2.4	Italy	2.4
Russia	2.0	UK	1.9
Italy	1.0	Lithuania	1.9
Other	14.5	Other	18.3
Customs free zone*	3.9		

**Introduced from 1999 and since it is not possible to divide this sum by countries*
Source: Bank of Estonia, February 2001

(excluding those with which it has free trade agreements). The duties are levied at rates varying from 5 to 59 per cent on live animals, animal and vegetable products, prepared foodstuffs, alcohol and tobacco.

An agreement between Estonia, Latvia and Lithuania on a uniform transit procedure took effect on 1 January 2001. It introduced uniform customs requirements for cargo in transit, so that different documents do not have to be produced and different procedures followed in each Baltic state.

Along with Latvia and Lithuania, Estonia is a member of the Baltic Free Trade Agreement (BFTA), which first came into effect in 1994 and is intended to be the first step in the formation of a customs union. Following agreement among all three states to accept free trade for all domestic products, the BFTA was modified and became law from January 1997. The agreement is the first of its kind, as it provides for completely free trade in domestically produced agricultural and food products before the formation of a customs union.

Taxation and social expenditure

Individual income tax and corporate (profit) tax are both charged at a flat rate of 26 per cent. As of January 2000, reinvested profit is not taxed in Estonia. Regulation No. 89, effective from 1 October 2000, established new forms of tax returns for non-resident taxpayers and changed some requirements pertaining to certificates of residence. Non-resident individuals and legal entities with no permanent establishment in Estonia must declare business income derived from Estonian sources on the new E1 tax return. Non-residents which have registered a branch or permanent establishment in Estonia need not file such a tax form.

The standard rate for **value added tax** (VAT) is 18 per cent, with exceptional rates of 0 and 5 per cent on certain goods and services. No VAT is levied on exports. **Excise taxes** are levied on tobacco, alcoholic beverages, motor fuel, motor vehicles and packages. There is a flat fee of EEK 200 for each customs declaration. Annual rates for **land tax** range from 0.5-2 per cent of the taxable value of the land and are set by local authorities

In response to the build-up of **pension** liabilities, the authorities are moving from the pay-as-you-go pension system to a three-tier partially funded scheme. The first tier became operational in January 1999 and is financed by 20 percentage points of the 33 per cent social tax on payroll paid by the employer while the rest of the **social tax**, 13 percentage points, is designated for **health care**. The third tier, introduced in July 1998, consists of voluntary contributions administered by private pension funds and insurance companies. The fully funded second tier will offer additional pension coverage financed by individual contributions. The second pillar shall be mandatory for contributors from the age of 18 and those who have once chosen to join it will not be allowed to switch back. The collection of contributions to the second pillar will start in January 2002.

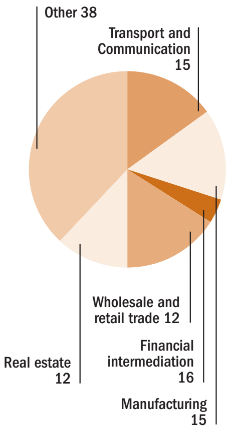
Major sectors of the economy

The service sector has been the star performer and driving force for the growth of the Estonian economy in 2000. The transport/transit sector has been performing especially well, since the Russian market has picked up strongly. Tourism has been booming. Industrial production was up as well in 2000. Investment in the production sector increased and the low euro (to which the kroon is effectively pegged) has boosted exports, especially in the electronics sector.

Food processing

Food processing is the largest processing industry in Estonia, accounting for about a quarter of industrial output. Dairy production, beverages – largely brewing – and fish processing are the most important sub-sectors. The main food exports are dairy and fish products, accounting for 25 per cent and 40 per cent of all food exports respectively. The Russian crisis of 1998 hit the sector hard but also gave an impetus to increased efficiency and to finding new markets, which have been successfully achieved. The food sector generally performed well in 2000, thanks to growing demand in foreign markets. With the Russian economy recovering, Estonian food producers have partly regained their traditional Russian market.

Sectoral breakdown of GDP



Source: Bank of Estonia

Dairy

Dairy processing grew by 6 per cent in 2000. Butter and ice cream production increased, while milk and cheese production decreased. Dairy products contribute the second largest share of food exports. The industry has invested intensively in technology and in bringing hygiene conditions in line with EU requirements.The EU (mainly Finland) had overtaken Russia as the main market.The biggest operator in the Estonian dairy industry, AS Põlva Piim, was the first to meet EU requirements and to be granted the right to export to the EU in 1998. Other large dairy producers are Ühinenud Meiereid (United Dairies) and Tallinna Piimatuööstus. Troubled Ühinenud Meiereid is 93.4 per cent owned by Hansapank, to which it is in debt. Hansapank is looking for a buyer for the dairy, and, to make it more attractive to an investor, has merged the domestically based company with Lacto, another heavily indebted dairy group mostly focusing on export. The bank offered the dairy group to Finnish dairy giant Valio, but was turned down.

Agriculture

Agriculture is entirely in private hands and the degree of consolidation in the sector has substantially increased, especially in the dairy sub-sector. The main agricultural sector is livestock and the principal crops are cereals (rye, wheat, oats), and vegetables. The share of agriculture in GDP is now around 3.5 per cent, down from 19 per cent at the end of the 1980s. The privatisation process of agricultural land is not yet completed. Fifty per cent of the land is to remain in public hands, the other half is to be private. Some 3 per cent is left to be privatised.

The strategy on agriculture adopted by parliament in June 2000 establishes the main goals and measures of Estonian agricultural and rural development policy for the period 2000-03. The strategy aims at increasing the efficiency of agricultural production, guaranteeing stable domestic prices as well as a stable supply of the main domestic foodstuffs, and contributing to the development of the rural economy. The strategy covers a set of concrete actions, including the introduction of market regulation measures, subsidies from the state budget and rural development measures. In March 2000 the ministry of agriculture underwent restructuring, including the creation of four new departments responsible for agriculture, rural development, veterinary and agribusiness matters and trade. In 2000, the state agricultural budget amounted to approximately € 46.6 million, of which € 15.1 million was to finance direct support schemes to farmers, € 8 million input support, and € 10.8 million general and other support measures. State support to agriculture represented 2.4 per cent of the total national budget. As other candidate countries, Estonia is to benefit from EU financial support in the preparation of the agricultural sector for accession. In March 2000, a SAPARD (Special Accession Programme for Agriculture and Rural Development) Agency was established within the Agricultural Register and Information Centre, consisting of two structures responsible, respectively, for the implementation of the SAPARD pre-accession funding and the administration of the existing national support schemes. One of the consequences of SAPARD in 2001 will be further consolidation of the existing dairy farms. In the years 2000-02 total financial assistance from SAPARD to Estonia amounts annually to € 12 million.

Brewing and distilling

Estonia's largest brewery, Saku Õlletehas (Saku Brewery), is owned by Baltic Beverages Holding (BBH) which was established in 1991 by Swedish-Norwegian Pripps Ringnes and Finland's Hartwall. Norway's Orkla owns half the shares in BBH. Saku Õlletehas's main product is the Saku Originaal brand of beer. In May 2000 Orkla announced a merger with Carlsberg Breweries (Denmark), which also owns one fifth of Hartwall. Thus, Saku Õlletehas is now owned by Carlsberg, for which Saku represents 1 per cent of total production. The change will not affect Saku, but some marketing restructuring may take place, as Carlsberg used to be Saku's rival, but now owns it. Saku holds around half of the Estonian beer market.

Holding company A. Le Coq is the Estonian subsidiary of Finnish brewer Olvi Oy and has the second largest market share. A. Le Coq fully owns the Tartu Brewery, which it has recently modernised at a cost of US$ 18 million. Olvi is making an additional investment of about US$ 3.3 million in the brewery, mainly to increase its share of the Estonian and Baltic markets. A. Le Coq's interests in the other Baltic states include 49.98 per cent in one of Lithuania's largest breweries, AB Ragutis, and an investment in Cesu Alus of Latvia, but the company is concentrating mainly on increasing its market share in Estonia. In 2000, A. Le Coq doubled its profits, with Tartu Brewery accounting for the lion's share. Tartu holds 38 per cent of the Estonian beer market,

Apart from the beer market, Saku and Tartu are competitors on the soft-drinks market. Saku currently holds 34 per cent of the Estonian soft drinks market, Tartu 30 per cent, Coca-Cola Company 14 per cent and PepsiCo 5 per cent. Saku is distributing PepsiCo's products throughout Estonia. A similar agreement between Tartu and Coca-Cola took effect in January 2001 after negotiations between Coca-Cola and Tartu's Finnish owner Olvi.

Liviko, Estonia's leading distillery, was one of the last large companies to be fully privatised in 1999. Eesti Ühispank, both as head of a group of local investors and through its subsidiary investment company Neokapital, became the majority owner of Liviko. Neokapital, which had paid US$ 6.8 million for 30 per cent in 1999, was committed to invest US$ 6 million in the company by 2002. Neokapital sold its shares to NG Kapital in summer 2000. Liviko has conceded its position as market leader in vodka production to Onistar, a Russian-owned distillery, and Ofelia, an Estonian distillery. The Onistar group in summer 2000 opened a new distillery in addition to its two existing distilleries in Estonia. In terms of total output of strong alcohol, Liviko still produces more than the other two put together. In 2000 Liviko retained its 30 per cent market share in alcohol sales.

Forestry and wood processing

Forestry and wood processing is one of Estonia's largest industries, accounting for 14 per cent of total industrial production. In 2000, timber industry production increased by 30 per cent. The forestry industry has a long tradition. Of Estonia's total land area, 47 per cent consists of forest (2 million hectares), which represents the highest wood supply per capita in Europe. The main types of wood are pine, spruce and birch.

There are over 300 sawmills in Estonia, with the 15 largest accounting for 50 per cent of total output. Privatisation in the forestry sector has been completed. Timber and wood products constitute Estonia's second highest export sector accounting for 17 per cent of the total. The sector is highly export-oriented, with about one-third of its output exported as unprocessed wood to EU markets, of which Finland and Sweden head the list with 90 per cent of the total.

AS Imavere Saeveski (Imavere Sawmill), a joint-stock company that operates one of Estonia's most modern sawmills and is one of the biggest sawmill companies in the Baltics, received a second (€ 5.1 million) EBRD loan at the end of 1999 to expand its production capacity. The loan supports the development of new technology that will strengthen the company's export competitiveness by making production more flexible and introducing the company to new markets. Imavere Sawmill is expanding the range of its export markets, has applied for a US export certificate and is involved in pilot projects to sell sawn timber there. Imavere Sawmill is partly owned by Stora Enso Timber Group (Finland), one of the biggest wood processing companies in Europe.

AS Paikuse Saeveski, majority-owned by Forestex, a subsidiary of UPM Kymmene (Finland), is one of the most modern sawmill companies in the Baltics. After an EEK 210 million (about US$ 13 million) investment in a new mill, it now produces at full capacity with exports accounting for 85 per cent of its production.

In 2000 an investment of about US$ 6 million was made into the new plywood and veneer factory FSS Plywood AS, with a capacity of 20,000 cubic metres of birch plywood per year, based in Otepää in the south-east of Estonia. The owners of the company are AS Forestex, AS Sylvester and Schaumann Wood OY (Finland).

Horizon Pulp and Paper, a leading paper factory based in Kehra, 50 kilometres east of Tallinn, is owned by Tolaram Group (Singapore). In 2000 it began reconstruction of its cellulose and paper factory, financed by loans from the IFC, Ühispank and Leonia Bank (Finland). The loan agreement marked the second stage of modernisation of the plant.

Textiles

Estonia's textile industry accounts for 8.8 per cent of industrial output and has traditionally been an important exporter, accounting for about 13 per cent of all exports. The industry has been rapidly increasing its market share in western Europe. Textile production increased by 20 per cent in 2000 after an extremely difficult year in 1999. The largest textile companies and biggest exporters are Kreenholm and Baltex (see below). Other large manufacturers such as AS Sangar STC, AS Virulane and AS Ilves-Extra, engage mainly in sub-contracted production and export more than half of their production, especially to the EU. AS Klementi exports almost 70 per cent of its production, mainly to EU markets. Although the Baltics are still an attractive option for investment by international companies, the cost advantage is slowly disappearing and competition, especially from China and India, is increasing.

Narva-based **Kreenholmi Valduse AS** (Kreenholm Holding), fully owned by Boras Wafveri (Sweden), is the largest textile plant in Estonia and one of the biggest in Europe, employing about 4,650 people. In 2000, the company received a second loan package from the IFC worth US$ 30 million. Kreenholm invested two-thirds of this loan into facilities such as power looms, boilerhouses, and sewing and spinning equipment. One third of the loan was used to refinance existing loans and increase turnover funds. The investments are being carried out until 2002. As a part of the investment, a new 7,000 square metre sewing factory built at a cost of US$ 1.09 million, was completed in March 2001 and went into operation in mid-April 2001, creating over 300 jobs. Kreenholm's sales in 2000 were up 28 per cent from 1999. Exports into the EU make up 62 per cent of total sales, exports to the US 22 per cent, and those to the Baltic states 6 per cent. Kreenholm plans to boost its sales turnover in the next five years from EEK 1.2 billion (about US$ 75 million) to EEK 1.6 billion (about US$ 100 million).

The Baltex Group, the second largest textile manufacturer in Estonia, consists of the former Balti Manifaktuur factory, based in Tallinn, and its spinning and knitting subsidiary Qualitex, based in Sindi. Balti Manifaktuur was renamed Baltex 2000 following its takeover in 1995 by Tolaram Group (Singapore). Since then the company has tripled its sales, and exports almost its total production to mainly EU markets. Baltex's strategy was to expand its west European markets and in 1999 it embarked on a DM 56.5 million modernisation programme, for which the EBRD provided DM 17 million in loan and equity financing. The financing was used to modernise both factories. Hansapank extended an EEK 36 million (US$ 2.25 million) long-term loan and provided Baltex with EEK 32 million (US$ 2.13 million) in working capital. As part of its expansion into new markets, Baltex has started selling its products in the US. In summer 2000, Baltex was awarded an ISO 9002 quality certificate, guaranteeing that its products meet EU standards. In 2000 Baltex boosted its turnover by 35 per cent and made profits again, compared to zero profits in 1999, which was an exceptionally bad year for textile companies.

Electronics

The electronics sector was a star performer in 2000, achieving rapid growth and increasing exports considerably, especially to the EU. Elcoteq Tallinn, a subsidiary of Finnish electronics manufacturer Elcoteq, produces electronic valves, tubes and other electronic parts, such as cellphone components for Nokia and Ericsson among others. The company employs 3,150 people, but this number is reportedly to be reduced by 600 following Ericsson's announcement in February 2001 of plans to sell its mobile phone production to a US company. Elcoteq is expanding a communications networking plant currently under reconstruction in Estonia, which will come fully on line during 2001. Elcoteq is also planning to build an 11,000 square metre facility in Wroclaw, Poland, which would focus on communications and industrial electronics.

Electronics components producer PMJ Automec Oy (Finland) launched its Tallinn factory in the spring of 2001. AS Tarkon, another electronic parts maker, has a new supply contract with Smarteq (Sweden), producer of communications equipment for Volvo trucks. The Smarteq order is expected to make up 7 per cent of AS Tarkon's annual sales in 2001.

Information technology

International investors are showing increasing interest in IT businesses in the Baltic region. In 2000, IT firms in Estonia, Latvia and Lithuania enjoyed an unprecedented inflow of investments, totalling about US$ 50 million, mainly from investment funds. There are only six Baltic IT companies worth more than EEK 100 million (US$ 5.7 million), including two Estonian firms: MicroLink (EEK 780 million) and Helmes (EEK 100 million). A smaller Estonian software developer is Assert.

MicroLink in its present form has resulted from the merger of many small firms to create a stronger single holding company, likely to be more attractive to investors. The largest IT concern in the Baltics saw its turnover grow by 67 per cent in its previous financial year. The company's IT services division contributed the largest part of the turnover. Branches of the IT services division cover systems integration (notably Microlink Susteemid), software manufacturing, service and retail firms (retail chain OK Arvutid). The fast growth was mainly based on mergers with Latvian and Lithuanian firms. MicroLink took over 20 other companies in the financial year ending 30 June 2000, including Latvia's largest IT firms Fortech and VAR. In the same period it sold Lithuanian distribution firm Taide to Cygate AB (Sweden) and cable maker MicroLink Elektroonika to Amphenol (US).

In the previous financial year, MicroLink set up the Delfi Internet portal and an e-business chain in Estonia, Latvia, Lithuania and Russia (see E-commerce below), and focused on fast-growing fields with high profit margins such as IT and Internet services. MicroLink posted a loss in 1999-2000, but in the first quarter of the 2000-01 financial year increased sales threefold over the same quarter in 1999. MicroLink predicts over EEK 1 billion (US$ 62.5 million) turnover in the current financial year, more than double the total from the previous year. At the end of 2000, the company secured a contract to manage a data network for Sampo Kindlustus, Estonia's biggest insurer, a unit of Sampo (Finland). Microlink was also responsible for building Sampo's network in autumn 2000.

Sybase (US), a leading supplier of database software, is setting up a company in Estonia to coordinate operations, sales and marketing. Sybase Baltic, the Finnish subsidiary of Sybase Inc, has set up separate units in Latvia and Lithuania as well. Sybase aims to become the leading supplier of mobile and Internet solutions in the Baltic region.

Telecommunications

In February 2000, the Estonian parliament adopted a new telecommunications law in line with EU directives that opened the fixed-line telephone market to competition from January 2001, ending the seven-year monopoly of Eesti Telefon (the fixed-line arm of state provider Eesti Telekom). Approval of the January 2001 liberalisation date placed Estonia among the first east European countries to open up all segments of its telecoms market.

A new agreement between the Estonian state and Eesti Telefon was concluded to help create better conditions for competition to emerge. The agreement obliges Eesti Telefon to allow access to its network and offer connecting services to others, and to develop its phone network to a level that guarantees the consumer a set individual telephone number and the ability to choose among telecommunication service providers by 1 January 2004. Eesti Telefon is not required to coordinate its tariffs with the government any more as pricing is now regulated by a separate law. Eesti Telefon is creating a subsidiary which will focus on the construction and administration of its telecoms network, leaving the parent company to concentrate on strategic planning.

Eesti Telefon, which had the fixed-line monopoly until the end of 2000, in November 2000 signed an agreement with AS Uninet, owned by Radiolinja (Finland), which enables Uninet's clients to use Eesti Telefon's network connections. Uninet, one of the new operators competing with the previous monopolist from 2001, plans to take 25 per cent of the Estonian market in its first three years of operation. Uninet started offering telephone services from 1 January 2001, including international and long-distance calls, local calls and calls into the cellular network. Eesti Telefon signed the first such agreement in October 2000 with Tele2 (see *Mobile telecommunications* below), enabling Tele2 to receive a fee from Internet calls that go via its network. Eesti Telefon has set tariffs of US$ 0.01 per minute and a charge of US$ 0.01 per call for the operators who use its network. At the end of November Uninet and Tele2 signed an agreement to connect their phone networks, enabling their clients to cross-use the networks without travelling via the Eesti Telefon network. The national and regional cross-usage fees are 30 per cent lower than the lowest fees in Europe.

Part of Eesti Telekom was floated through an issue of GDRs on the London Stock Exchange and an IPO on the Tallinn Stock Exchange in February 1999. The issue raised around US$ 221 million, the largest international equity offering from the Baltic countries so far. Baltic Tele AB, a consortium of Sonera (Finland) and Telia (Sweden), holds a stake of 49 per cent, and the government retains a 27.3 per cent stake, as well as a golden share with veto rights over certain strategic corporate decisions, which is to expire at the end of 2002. Following the success of the IPO, the government considered a rapid sale of its remaining 27.3 per cent stake. It wanted to set a timetable and method for the sell-off in 2000, but also retain its veto rights through the golden share. However, the government has now postponed its plans until the second half of 2001, to await the effects of the market liberalisation and more favourable market conditions.

Eesti Telekom is to benefit from a five-year € 40 million revolving credit facility arranged by an international syndicate of banks. The joint arrangers are Bankgesellschaft Berlin AG (Germany), Hansapank, Dai-Ichi Kangyo Bank Ltd (Japan), Landesbank Schleswig-Holstein Tallinn (Germany), Leonia Bank plc (Finland, now Sampo Bank) and Swedbank (Sweden). The main purpose of the credit facility is to secure the firm's position ahead of liberalisation of the telecoms market.

Mobile telecommunications

Estonia has the highest cellular penetration among the transition countries (35 per cent), higher than in some EU countries. Estonia has three mobile operators, competition between whom is intense, and the market is booming. Unlike some west European countries that have earned billions of dollars through the sale of licences for UMTS, the third-generation mobile communication standard, Estonia is not planning to issue licences by auction as this would make the new service more expensive for users. A pan-Baltic working group has examined the idea of offering one licence for all three Baltic countries to a single operator, but advised against this in early 2001.

EMT (Eesti Mobiiltelefon, Estonian Mobile Telephone Co), a subsidiary of Eesti Telekom, is the oldest and biggest mobile operator. EMT launched an NMT 450 network in 1991 and became the first operator of a GSM network in January 1995. EMT is benefiting substantially from being the number one business operator in Estonia. EMT had 327,000 subscribers (representing more than 60 per cent market share) at the beginning of 2001. Especially successful is the pre-pay SIMPEL product: about two-thirds of all new customers opt for this service. EMT owns the cellular telephone retailer AS Esmofon, whose market share in EMT subscription agreements is over 50 per cent. In October 2000 EMT acquired 5 per cent of Mgine Technologies, a Finnish-Estonian company that focuses on personalisation and mobile positioning software products. The remaining 95 per cent of Mgine is owned by DONE (Digital Open Network Environment) Corporation, an e-solutions company listed on the Helsinki stock exchange.

Radiolinja Eesti, a joint venture between Radiolinja Oy and Helsinkin Puhelin (both Finland), launched the nation's second GSM network in 1995. By October 2000, Radiolinja Eesti had 118,000 clients (a 23 per cent market share). Since 1 January 2001 Radiolinja is offering fixed-line services through its subsidiary Uninet, using Eesti Telefon's networks.

QGSM is the GSM service provided by network-owner Ritabell, which is 94.8 per cent owned by NetCom Systems AB (Sweden). Ritabell entered the Estonian market in 1997. NetCom-controlled Levicom Cellular is now expanding its business into Lithuania, where it has set up mobile phone company Tele2. QGSM greeted its one-hundred-thousandth client at the end of 2000, when it reached a 15.5 per cent market share. Tele2 is also providing fixed-line telephone services from 1 January 2001, using Eesti Telefon's networks.

Internet

Several firms have started offering wireless Internet services to compete with the traditional data links, which depended on the monopoly of Eesti Telefon but lost competitiveness due to high telephone rates. Telediffusion de France, which has become 49 per cent shareholder in the Estonian Broadcasting Transmission Centre Ltd (Ringhäälingu Saatekeskus), plans to offer rapid

E-commerce

The Estonian government has played a big role in encouraging e-commerce. It was the first of the Baltic republics to pass an electronic signature bill on 9 March 2000. Most Estonians only have Internet access at the work place, and over the past few years the governemnt has installed computers in many government offices and has encouraged companies to do the same in the private sector. In the fourth quarter of 2000, 30 per cent of the population aged between 15 and 74 were using the Internet, of whom 22 per cent were active users. Twenty per cent of the same population group had PCs at home.

MicroLink, the leading Estonian IT group (see *Information technology* above), last year introduced the Delfi internet portal. The Delfi portal firm manages Estonian, Latvian, and Lithuanian portals in the local languages and Russian-language portals in Estonia, Latvia and Russia. MicroLink adapted the structure of the Delfi group to increase the development of its main spheres of operation and to be more attractive to investors. The internet service provider unites an Estonian company set up on the basis of MicroLink Online, as well as Latvian and Lithuanian firms in the same sphere. Index Net, a leading Estonian e-commerce software developer, has been granted an ISO 9001 quality certificate, the first e-commerce software maker in Estonia to comply with the necessary international quality standards. Index Net was established in 1998 and has representative firms in Latvia and Finland. The company develops and sells e-commerce solutions, maintains the Internet portal www.index.ee and manages ***www.index100.ee***, the largest e-commerce site in the Baltic countries.

Electronic banking

Estonian banks were very quick to adopt online banking. Hansapank first rolled out Internet services in 1997. Of the 10 Internet-accessible banks in Europe at that time, three were Estonian. Hansapank is also setting up e-banking operations in Latvia and Lithuania. Products include current account services, mutual funds, stock and bond trading, electricity and phone bill payment, loan applications and money transfers on an Estonian-English bilingual website. Hansapank also has more than 40 online merchants signed up for a virtual shopping centre, similar to that of Swedish-Finnish banking group Merita Nordbanken, which allows customers to make direct payments to businessess. Hansapank is also active on the mobile banking front. Its WAP mobile banking service, in partnership with Ericsson and Nokia, began operating at the end of June 2000 and offers basic banking services. The bank is currently looking at moving its Bank Link direct payments service onto WAP. On the B2B side, Hansapank, along with its rival Eesti Ühispank and telecoms operators Eesti Telefon and Eesti Mobiiltelefon (EMT), has signed an agreement to develop a joint public key infrastructure security network to accelerate B2B, and certification and authorisation services.

radio links to Internet service providers, including in rural areas. Telediffusion paid US$ 5.26 million for its stake and will invest an additional US$ 15 million in the Estonian Broadcasting Transmission Centre Ltd over three years. The TRL Group has a wireless link under the name VEMIS, for which the Baltic Small Equity Fund (see *EBRD activities* below) provided US$ 140,000.

Cable TV, mobile phone and Internet services company Tele2 completed its first station in Tallinn in December. Ericsson (Sweden) installed the Broadband Wireless Access substation for Tele2, after which in early 2001 Tele2 started providing BWA-based online Internet link-ups, data transmission solutions, and local area network link-ups. Pangea Networks, a Bermuda-based provider of carrier network services, is building a high-band-width telecommunication network covering the Nordic and Baltic countries, and launched the first phase of the network in Estonia in December, when it connected the UK, the Netherlands, Germany, Denmark, Norway, Sweden, Finland and Estonia.

Eesti Telefon does not yet offer wireless telephone and Internet links but will in the near future. The company's fixed-line monopoly until 1 January 2001 has given it a comparative advantage. It has recently more than quadrupled the capacity of a direct Internet link with Sweden, which increased the aggregate capacity of its international Internet links to 50 megabytes per second (mbps). In cooperation with Telia (Sweden) Eesti Telefon raised the capacity of the direct link to 34 mbps. Apart from the link with Sweden, Eesti Telefon has an up to 12 mbps direct link with Canada and links with Latvia and Russia with a speed range of 2 mbps.

Energy

The energy sector contributes around 4 per cent of GDP. The Energy Act, in force since January 1998, covers issues such as liberalisation of energy markets (including third party access and price transparency) and transit of power and gas. Its underlying market principles are modelled on the EU Electricity Directive. The Act provides for a regulator, the Energy Market Inspectorate, which establishes service standards, polices and fines companies for non-compliance and advises the Ministry of Economy on environmental and labour safety matters. The power sector has been unbundled and is in the process of being privatised.

Energy generation

Eesti Energia (Estonian Energy, EE), the integrated state power company, and the Estonian government finalised negotiations with NRG Energy (US), a unit of Northern States Power, for the sale of Narva Power (Narva Elektrijaamad) which includes EE's two largest thermal power plants, Narva and Baltic. After lengthy negotiations in August 2000 the Estonian government signed an agreement under which NRG was to buy a 49 per cent stake in Narva Power, which apart from the two power stations owns a 51 per cent interest in the state-owned oil-shale company, Eesti Põlevkivi. The oil-shale generation plants account for 92 per cent of Estonia's and one-third of Latvia's electricity. The government had postponed the deadline for agreement while considering whether to include the oil-shale mines in the deal, until it was finally decided that 51 per cent of Eesti Põlevkivi would be given to the power plants, to be privatised after restructuring. EE is to retain 51 per cent in Narva Power.

NRG should pay US$ 70.5 million for its stake, of which US$ 65.5 million down payment. Under the terms of the agreement, the Narva Power plants will sell approximately 6.2 terawatt-hours of electricity to EE annually at a weighted average price to be settled yet. NRG will also invest around US$ 300 million in the power stations over the coming years, US$ 218 million of which in plant renovation. In addition, NRG has committed to set up a US$ 5 million social security fund for workers made redundant from the plants.

Energy distribution

Smaller energy assets have already been privatised. Since 1999 Eesti Ühispank, the second largest Estonian bank (majority-owned by Sweden's SEB), and Fortum Oil & Gas (Finland), own 30 and 70 per cent respectively of Viru Energia, a power generator and distributor. Fortum is committed to investing EEK 700 million (US$ 47 million) in Viru Energia during the first five years. Fortum also has controlling stakes in two other electricity distributors, Viimsi Elekter and AS Läänemaa Elektrivõrk.

Vattenfall (Sweden), the largest Nordic energy company which since 1999 already owned a 95.6 per cent stake in Ülejõe Soojusvõrk, a Pärnu-based district heating company, has in January 2001 acquired a 99.95 per cent stake in the municipal district heating company Pärnu Soojusvõrk. Pärnu Soojusvõrk is Estonia's fifth largest heating utility. The municipality will retain control of the heating company through a golden share.

Vattenfall is considering developing a biomass-fired combined heat and power (CHP) plant in Pärnu, but is awaiting developments in NRG's deal for Narva Elektrijaamad before making a final decision. Electricity produced by the plant would be sold to the grid, while its heat output would be used to supply Pärnu's heating system.

Energy transmission

A project known as Estlink is currently under way to establish an underwater cable between Finland and Estonia to export surplus power by 2002. This cable will connect Estonia to the Nordic countries' NORDEL system. Partners with EE in the project are ABB (Sweden-Switzerland), the Finnish PVO Group, Helsinki Energia, and Sweden's Graningenverkens AV.

Gas

Single gas utiliy AS Eesti Gaas (Estonian Gas) is fully privately owned since the last remaining 11.4 per cent state-owned shares were sold in early 1999 to Ruhrgas (Germany), making it the second largest single shareholder with 26 per cent. Gazprom (Russia) holds 37 per cent, Fortum Oil & Gas around 10 per cent and portfolio investors hold 27 per cent of shares. Eesti Gaas now has a sound, strategic ownership structure, and restructuring is advancing well.

Eesti Gaas has a long-term gas purchase agreement for 2000-05 with Gazprom, which ensures the necessary supply for this period, with potential increase in the volume of consumption taken into account.

Transport

Estonia is an important transit route for Russia in its trade with western markets. Providing transit services for Russian clients has resulted in huge investment in the transport infrastructure. Together with storage and communications, there are more than 3,300 transport enterprises, which contribute some 15 per cent to Estonia's GDP. Transport and transit services were the driving force of the Estonian economy in 2000. There was a sharp increase in oil trans-shipment from Russia, although the volume of transport of oil products by rail started to fall in the last quarter. The recovery of the Russian economy also fuelled stronger exports from the EU to Russia.

Sea ports

An estimated 80 per cent of all the cargo handled by Estonian ports is transit trade between Russia and the EU. Petrochemical products, cereals and wood products are the most transported goods. Total freight turnover has increased considerably in 2000. The largest ports are all in the Tallinn region: Tallinn Old City Harbour (formerly Kesklinna Harbour), Paljassaare Harbour (formerly Kopli Harbour) and Muuga Harbour, 17 kilometres from the centre of Tallinn. These state-owned harbours are administered by Port of Tallinn Ltd, which represents 70 per cent of the total trade turnover of Estonia's harbours.

At **Muuga** deep-water port a free zone was established in 1997. Goods can be kept in the free zone without declaration until they are taken out of the port area. The loading process is faster and cheaper without a bonded warehouse and terminal system. Muuga can handle vessels of up to 150,000 tonnes and has a depth of 18 metres. It is one of the most advanced ports in the region, with modern facilities for grain, perishables, ro-ro traffic and oil products. An increasing number of international companies use the port for transport and logistical operations. Muuga has state of the art cold storage facilities and grain silos, with German-trained management. More than 50 firms, mainly cargo transport companies, operate at Muuga port.

Petrochemical products account for more than 40 per cent of total goods transported through Estonian ports and Muuga has become the busiest trans-shipment point for Russian crude oil. Of the port's cargo turnover, 70 per cent is contributed by fuels, and the port is attracting substantial investment. Denmark's Eurodek is investing EEK 300 million (US$ 18.75 million) in Muuga Port, of which EEK 80 million (US$ 5 million) is for the development of a new oil trans-shipment terminal with an annual handling capacity of 350,000 tonnes. Russia's Lukoil is increasing its oil transit shipments through Muuga and wants to expand Lukoil Denmark's Transkeemia oil terminal at Muuga to increase the transit flow.

The Port of Tallinn Ltd is investing in building a liquid chemical storage and processing terminal and a dry bulk terminal at Muuga port. The first stage of construction of the dry bulk terminal is complete, enabling the harbour to handle at least 1 million tonnes of fertiliser per year. The Port of Tallinn is also investing into the Muuga port railway to improve the organisation of the railway system, to guarantee all investors access to terminals and increase the port railway capacity.

The Port of Tallinn has invested EEK 160 million (US$ 8.8 million) in a new container terminal with a capacity of 250,000 tonnes per year. Estonian construction company Eesti Ehitus in early December 2000 finished work on the new container terminal, which started handling cargo soon after. The terminal, with a 200-metre quay and maximum 14.5 metres water depth at quayside, is operated by Muuga CT, a holding of Transiidikeskus AS (Transit Centre Ltd).

Tallinn Old City Harbour is one of the biggest passenger ports in the Baltic region, servicing almost 6 million people a year. The Tallinn-Helsinki route accounts for the great majority of traffic, about 90 per cent. Ferry operator Tallink alone carries over 2 million passengers a year between Helsinki and Tallinn. By comparison, the second most popular passenger route, between Stockholm and Tallinn, only accounts for about 8 per cent of traffic. The Port of Tallinn Ltd is investing in expansion of the existing passenger terminals at the Old City Harbour and construction of new terminals.

Railways

Restructuring of the rail sector in Estonia began in 1997 with the transfer of domestic passenger services from Eesti Raudtee (Estonian Railways) to Edelaraudtee (South West Railways). In December 1998, a tender was issued for the

Estonian Railways

AS Eesti Raudtee, or Estonian Railways (ER), was established as a state enterprise in 1992 and later became a joint stock company wholly owned by the Estonian state. Originally it owned and managed the rail infrastructure and operated freight and passenger services. In 1997, domestic passenger services were transferred to a new company, Edelaraudtee, which has recently been sold to a strategic investor. In 1999, ER's international passenger services and commuter passenger services were established as separate companies, EVR Ekspress and Elektriraudtee respectively. ER retains an interest in both of these companies.

An IFI-financed priority investment programme to renew track on the Tallinn-Narva line and reconstruct the Narva border station and marshalling yard commenced in 1996, with a loan provided by the European Investment Bank (EIB), which funded the track renewal. The second phase of the programme, for which the EBRD provided a loan in April 1999, involves reconstruction of the Narva border station and marshalling yard. This together with the planned rehabilitation and rationalisation of the marshalling yards at Tapa and Tallinn is intended to alleviate infrastructure bottlenecks on the heavy freight transit route from the CIS to Estonia's ports. The EBRD project has been delayed pending the privatisation of ER, but is expected to remain a priority for the strategic investor.

In addition, ER has been implementing a management development programme, which includes improvements in management control systems. The objectives of the overall investment programme were to:

- Protect international freight transit revenues by rehabilitating key life-expired infrastructure;
- Meet growing demand for freight services by expanding the capacity of the infrastructure and implementing a modern block train operating strategy;
- Improve conditions for successful privatisation of the freight train operations through the infrastructure improvements;
- Improve safety and working conditions for employees; and
- Improve the management of waste materials generated by railway maintenance and operational activities.

The total cost of the priority investment programme was estimated at € 73 million, of which ER/the Estonian government was expected to contribute up to € 37 million (part of this to be contributed by a strategic partner). The programme was co-financed by the EBRD (€ 15 million) and the EIB (€ 16 million), and by an EU-Pharegrant (€ 5 million).

In February 1999, the government approved a programme that included the privatisation of Estonian Railways through the sale of shares. In January 2000, the EBRD provided technical co-operation assistance to the Estonian Privatisation Agency (EPA) to prepare a detailed privatisation plan for Estonian Railways.

In April 2000, the government announced the privatisation tender for a 66 per cent stake in ER. In December 2000, Rail Estonia, a consortium of North American firms, was declared the preferred bidder and entered into negotiations with the government to conclude the sale. In January 2001, the process was suspended by a legal challenge from one of the other bidders, Raudtee Erastamise Rahva (RER, People's Railway Privatisation) pending a court hearing in the middle of March 2001. In the meantime, Rail Estonia's bid failed and a partial withdrawal of RER's legal challenge at the beginning of March 2001 allowed the EPA to open negotiations with the second placed bidder, Baltic Rail Services. While these negotiations are ongoing, at the time of writing, the remainder of RER's legal challenge is still to be resolved.

sale of 100 per cent of the shares in Edelaraudtee to a strategic investor. GB Railways (UK) was declared the preferred bidder in July 1999. Negotiation of the sale was delayed by protracted discussions on the level of subsidy to be provided by the government to Edelaraudtee to meet its passenger service obligation. Negotiations were finalised and the sale agreement signed at the end of November 2000. Following the sale, some rationalisation of the passenger network is now taking place.

In 1999 also, Eesti Raudtee's international passenger services were transferred to EVR Ekspress, a private joint venture in which Eesti Raudtee retained a 49 per cent stake. Elektriraudtee was established as a wholly-owned subsidiary of Eesti Raudtee to operate its commuter services.

Eesti Raudtee's core business is now provision of freight services and operation and management of the national rail network. By far the largest volume of transit traffic in Estonia is carried by rail, which is likely to remain the principal mode of transport for some years to come. The total freight carried in 1999 was more than 35 million tonnes, of which 60 per cent was in transit. The main line is the east-west railway link with Russia via Narva and Tapa.

In February 1999, parliament approved a new Railways Act, which was intended to harmonise Estonian railway legislation with EU legislation. The Act provided for the licensing of railway operators and open access to the national rail network. The Ministry of Transport and Communications issued licences for engaging in railway transport to 12 operators, including Eesti Raudtee, its subsidiaries and Edelaraudtee.

In April 2000, the government announced an international tender for the sale of a 66 per cent stake in Eesti Raudtee to a strategic investor. (See previous page.) Elektriraudtee and EVR Ekspress were excluded from the sale. In the autumn of 2000, the Ministry of Transport assumed management of Eesti Raudtee's shares in these companies. Elektriraudtee may be transferred to the City of Tallinn.

Oil transit

Pakterminal and Estonian Oil Service (EOS) are the major oil transit railway companies. In autumn 2000, both experienced a drop in transit volume after a decade of uninterrupted growth. Well-timed investments and well-placed railroads have made Tallinn the leading export channel for Russian refined oil products, which, unlike crude oil, cannot be sent through pipelines. The oil transit trade is of vital importance to the Estonian economy. However, the Russian government is now reducing its dependence on foreign ports. It has expanded the St. Petersburg Oil Terminal and is developing a Baltic oil port in the northern city of Primorsk, which is to be supplied by a new pipeline, scheduled for completion in 2001. Besides, fuel transit through the Baltic states no longer enjoys preferential terms by the Russian railways, as a result of which rates have risen by more than 50 per cent.

Thanks to the large quantities of crude and fuel carried in the first half of 2000, freight turnover for the full year surpassed that recorded in 1999. However, in September 2000 the volume of fuel-oil exports was lower than the same month a year earlier for the first time in five years. In October, cargo turnover dropped by 25 per cent. The reasons for the drop included growth in Russian domestic demand and increasing export through pipelines supported by high crude prices on world markets, which left Russian refineries with less crude. Increased rail tariffs are another reason for the decreased performance of both Pakterminal and EOS. A joint venture between Pakterminal, Eesti Raudtee, October Railways (Russia) and Kinex (Russia) manages rail transportation between Muuga port and the Kirishi oil refinery. Seventy per cent of Pakterminal's throughput comes from Kirishi.

Civil aviation

The Aeroflot infrastructure that Estonia inherited after the break-up of the Soviet Union was subsequently reorganised into separate enterprises. The air navigation system became part of the Estonian Civil Aviation Administration. The airports became a state enterprise, Estonian Airports. The airline, Estonian Air, was the first privatised state carrier in eastern Europe: in 1996 Maersk Air (Denmark) bought 49 per cent of its shares and Baltic Cresco Investment 17 per cent, while the state retained 34 per cent. In addition to extensive cooperation with Maersk Air, Estonian Air has a commercial agreement (including code-sharing) with SAS. Estonian Air's winter schedule added flights to Stockholm and Moscow in November 2000.

Estonia's five airports became independent companies in 1997. At Tallinn Airport, the largest and only international airport, a runway renovation project was carried out in 1995, part-financed by the EBRD. The main building also underwent a full overhaul. A rapid rise in the exchange rate of the US dollar has substantially increased the loan burden of Tallinn Airport, forcing it to cut costs and halt planned investments, such as the acquisition of new runway cleaning equipment, building of premises for airport services and construction of an ice fighting platform. Some repairs were also put on hold. The reconstructed passenger terminal is working far below capacity, handling 600,000 passengers a year instead of a potential 1.5 million. Passenger turnover increased by about 3 per cent, while freight turnover decreased by 19 per cent in 2000.

The second largest airport, Tartu, was scheduled to be privatised at the end of 2000 and the sale was expected to be one of the largest privatisations of the year. However, the Estonian Privatisation Agency did not receive any bids by the 15 December deadline. Bidders were supposed to submit a three-year investment plan and a realistic business plan. The Privatisation Agency also required potential buyers to secure technical readiness to serve more international flights. Currently, Tartu Airport only has a regular international air link with Helsinki.

Retail

Retail sales rose by 12 per cent in 2000. According to the statistical office, consumer spending was pushed up by the introduction of simpler and more favourable lease-purchase arrangements for cars and home appliances.

The Baltic states are experiencing a shopping-mall boom. The Kristiine Kaubanduskeskus (shopping centre) in Tallinn, opened in the summer of 2000, is fully rented and is visited by an estimated 20,000 people per day. Real estate developer Pro Kapital floated 49 per cent of the Kristiine centre on the Tallinn Stock Exchange to use part of the income to invest in an expansion plan which includes an expanded car park, a multi-screen cinema and additional 9,000 square metres of shopping space.

The rapid growth in the number of shopping centres in Estonia in the past year has pushed down retail prices, making them equal or even lower than those at traditional street markets. The Astri shopping chain will open Lõunakeskus, a 15,000 square metre shopping mall, on the outskirts of Tartu in August 2001. It will be one of the biggest shopping centres in Estonia and is intended for southern Estonia's 300,000 inhabitants.

As a result of cooperation between ETK (Central Society of Estonian Consumers Co-operatives), the biggest retail trade group in Estonia, and Suomen Osuuskauppojen Keskuskunta (SOK, Finland) two Prisma supermarkets were opened in Tallinn in the second half of 2000, both of them among the biggest supermarkets in Estonia.

Baltic Food Holding (Sweden/Norway), a food retail and wholesale chain which has been rapidly expanding in the Baltic states, added 15 more shops in 2000 to the 65 shops and two wholesale companies it already had in Estonia and Lithuania, together with a distribution centre in Latvia. The main shareholders are Selvaag Gruppen (Norway), the Norwegian Government Regional Development Fund, Axfood AB (Sweden), and the managing director and chairman of the board who set up Baltic Food Holding together in 1995.

Financing of € 12.1 million from the EBRD is enabling Baltic Food Holding to develop its retail and wholesale activities in Estonia, Latvia and Lithuania by acquiring new supermarkets, upgrading its existing stores and expanding wholesale operations. The financing consists of € 6.6 million to Baltic Food Holding Estonia and a € 5.5 million equity investment in Baltic Food Holding AS, which is based in Norway. The project is enabling the company to expand even faster and become one of the main players in food retail and wholesale in all the Baltic countries.

Tallinna Vesi (Tallinn Water)

AS Tallinna Vesi (Tallinn Water) owns and operates the water and sewerage infrastructures of the City of Tallinn (415,300 inhabitants) and the town of Saue (4,500 inhabitants). The core business activity is the provision of water and sewerage services in Tallinn and the surrounding area. The company is organised into three divisions: water production, waste-water treatment and operation of the water and waste-water networks. The sewerage network (890 kilometres) needs substantial investments over the next six years, as it is the priority of the City of Tallinn to achieve full sewerage collection coverage.

In September 1994 the EBRD signed a loan agreement with Tallinna Vesi for € 22.5 million. The proceeds were used for the rehabilitation of water and waste-water treatment plants, ground water wells and the water and waste-water distribution networks as well as to purchase and install water meters. This investment programme has been completed.

Tallinna Vesi has been in existence for more than 100 years and was incorporated as a joint stock company in August 1997. All shares in the joint stock company were held by the City of Tallinn through the Tallinn Property Board. The company is managed by a two-tier Supervisory Council (10 members) and Management Board (five members) system. Both bodies are appointed by the City of Tallinn.

On 15 June 2000 the Tallinn City Council passed a resolution to privatise Tallinna Vesi via an international tender. The privatisation would take place through the sale of a 50.4 per cent equity stake in the company to a strategic investor by the end of 2000. The privatisation process would be open and transparent. Upon privatisation, the strategic investor would receive management control of the company, a majority of seats on the Supervisory Board and the right to appoint the members of the Management Board.

The City of Tallinn would retain control over certain matters, the most important of which is a veto on any future sale of shares by the eventual purchaser of the controlling stake in Tallinna Vesi. As the owner of a golden share in the company, and as party to the Shareholders' Agreement, the City of Tallinn will retain this right. The City of Tallinn was advised on the privatisation process by Severn Trent, the consulting arm of a reputable British water utility, and by Suprema Securities, a local merchant bank.

An EBRD project, signed in October 2000, supported the privatisation by re-financing, in advance of the privatisation, Tallinna Vesi's debt, making the company more attractive to international bidders. In addition, the re-financing as a direct corporate loan to the company sent a signal to the markets and governments in the Baltic region that self-financing local services can be financed without recourse to sovereign guarantees. The scope of the transaction was to support the privatisation by establishing in advance the terms and conditions for the existing long-term debt, and to provide regulatory and political comfort to the strategic investor.

The transaction involved a € 22.5 million corporate loan, consisting of a € 15.5 million re-financing of the 1994 sovereign guaranteed loan and additional financing of € 7 million. In addition the EBRD expressed its interest in taking a direct equity investment of up to € 10 million in the capital of the company, representing at par value approximately 14 per cent of Tallinna Vesi's capital and voting rights. Three companies submitted qualification applications for the privatisation. All three of the bidders were known in the industry as reputable international companies and met the minimum pass/fail criteria. Under the applicable covenants of the existing loan agreement the EBRD had a right of no-objection to the sale of a substantial share of Tallinna Vesi. In January 2001, the City of Tallinn sold the 50.4 per cent majority stake to British International Water and United Utilities for US$ 78.2 million.

Financial sector

Estonia's financial sector is one of the most developed among all the transition countries. The financial system consists of a central bank (the Bank of Estonia), seven commercial banks (including a subsidiary of a foreign bank), 21 securities brokers, one stock exchange, seven non-life and six life insurance companies, 15 investment funds and two private pension funds. The Bank of Estonia has sold its stake in Optiva Pank, the last bank in which the state had an ownership interest. The commercial banks are largely in foreign (Nordic) hands and are actively expanding their activities in the other Baltic states. The securities market is further integrating in the Baltic and Nordic region. The role of investment funds has decreased in the past few years.

The main legal act regulating the banking sector is the Law on Credit Institutions, effective since 20 January 1995 and renewed from 1 July 1999 in accordance with EU legislation. The new Insurance Activities Act, which is in conformity with EU legislation, was passed by parliament in June 2000 and entered into force on August 2000. The Act of the Estonian Central Register of Securities was passed on 14 June 2000 and entered into force on 1 January 2001. The new draft Securities Market Act, which was submitted in the second half of 2000 and is currently being read in parliament, is also in line with EU directives.

An integrated financial supervisory authority for banking, securities and insurance is in the process of being established. By merging the present three supervisory authorities it is expected to achieve new quality in financial sector supervision. The establishment of an effectively operating unified financial supervisory authority will ensure the independence of the authority, and adequate financing and cooperation mechanisms between the Bank of Estonia and the ministry of finance. The subordination of the new authority has not been decided yet. However, it will be independent in its decisions regardless of the administrative relationship. The main sources of financing for the authority will be contributions from market participants. The draft Act on Financial Supervision, which will decide the basis and future operation of the proposed body, was approved by the government on 19 December 2000 and has been submitted to parliament. The integrated financial supervision authority will start operating from 1 January 2002.

Banking sector

The bank regulatory framework is predominantly based on EU standards and Estonia complies with most of the major European banking regulations. Banking supervision has gradually strengthened and, according to the authorities, legal arrangements are now mostly in compliance with the Basle core principles.

The Estonian banks are the most efficient financial intermediaries in the Baltic states. Following the mergers in recent years of Hansapank with Eesti Hoiupank (to become Hansapank), Eesti Ühispank with Tallinna Pank (now Eesti Ühispank), and Eesti Forekspank with the Estonian Investment Bank (forming Optiva Bank), there are now seven banks operating in Estonia, including one subsidiary of a foreign bank. The largest and second largest banks, Hansapank and Eesti Ühispank, have respectively 57 and 27 per cent of the country's banking assets and are also the two largest banks in the Baltic region.

Foreign investment in the banking sector

Swedish banks have most actively entered the Estonian banking system as strategic investors. In 1998, Swedbank increased its shareholding in Hansapank to 49.99 per cent and Skandinaviska Enskilda Banken (SEB, Sweden) acquired 36 per cent of Eesti Ühispank shares. A further strengthening of the sector followed in autumn 2000 when SEB increased its stake in Eesti Ühispank to almost 100 per cent through a cash offer for outstanding shares. SEB has also acquired virtually full ownership of Latvijas Unibanka and Vilniaus Bankas in Latvia and Lithuania respectively. In early January 2001, Swedbank acquired another 5 per cent in Hansapank from Bank Handlowy (Poland) through a buy option, which raised Swedbank's stake to 57.72 per cent. Swedish-owned Estonian banks have generally led the way in initiating a pan-Baltic presence, expanding their activities into Latvia and Lithuania. For example, Hansapank has introduced electronic banking in the Baltics. Swedbank, through its subsidiary Hansapank, now has plans to expand activities to the Russian Baltic (St. Petersburg) region. At the time of writing it is not yet clear what the consequences will be of the announced merger between SEB and Swedbank.

In June 2000, the central bank reached an agreement with Finland's Sampo Finance for the sale of its 58 per cent stake in Optiva Bank, the third largest bank in Estonia. Under the deal, Sampo Finance paid a total of around € 14 million and the central bank provided partial indemnity to cover the quality of the bank's assets. In addition, Sampo purchased the rest of Optiva shares owned by minority shareholders (including the 19 per cent stake of Eesti Ühispank). Sampo Finance managed to acquire a total of 93.5 per cent of shares and sold these to Sampo Insurance Company plc to have all its finacial services – banking, insurance and asset management – under one umbrella. The deal was approved by the Finnish financial supervision authority and competition board. Scandinavian insurance-banking concern Sampo-Leonia is the official majority owner of AS Sampo Pank. Optiva Pank's name was officially changed to AS Sampo Pank from 1 January 2001, but the name Optiva can also still be used.

Optiva Pank/Sampo Pank became the sole owner of asset management company EFM Optiva Varahaldus after buying 50 per cent of EFM's shares from asset management company East Fund Management (Austria) at the end of December. The company's new name became Sampo Varahaldus (Sampo Asset Management). In November 2000 Optiva Pank issued a € 30 million bond organised by Deutsche Bank (Germany). The issue was oversubscribed, mainly by emerging market funds in Germany and Austria. The funds raised through the issue were used to finance ongoing operations. Sampo Pank at the end of December secured a six-year € 10 million credit line from the EBRD to finance loans to SMEs.

Following the sale of Optiva Bank, the central bank and the government have no more shares in the banking sector, excluding some residential ownership of less than 1 per cent. The three largest banks, controlling more than 90 per cent of assets, are now all foreign-owned, with strengthened access to long-term, more secure funding and improved development perspectives.

Non-bank financial institutions

Securities market

As at February 2001, 22 companies were listed on the Tallinn Stock Exchange (TSE) and the market capitalisation stood at EEK 29 billion (approximately US$ 1.7 billion). The TSE is a non-profit company, established in 1995. It is a self-regulatory organisation and issues its own rules and regulations. The equity market is dominated by a small number of liquid stocks, specifically the larger banks and Eesti Telekom. These stocks represent about 93 per cent of the market capitalisation and over 90 per cent of total turnover of the TSE (as at January 2001). There is no treasury bills market and the government bond market is small, as the government has committed itself to run a balanced budget.

The securities market infrastructure is well advanced. The TSE operates an electronic online interactive trading system offering continuous quotation within an order-driven system and all securities are dematerialised. The clearing and settlement are processed on a DVP (delivery versus payment) basis. The Estonian Central Depository for Securities (ECDS) registers security ownership, clears transactions and provides market information services.

No distinction is made between domestic and foreign investors. Foreign investors seeking to acquire a stake in bank shares need approval from the central bank. In other sectors a stake over 10 per cent must be declared openly. Rules and regulations relating to public trading comply with international standards.

Foreign investors currently represent about 67 per cent of the turnover. The TSE is committed to providing information to both domestic and foreign investors. Since the trading system is online, trading information and news are available at the same time in Estonian as well as in English. Information is also available through Reuters, Bloomberg and other internationally known sources.

In January 2000, parliament approved changes to the Securities Market Act, the Investment Funds Act and the Criminal Code designed to protect minority shareholders and improve transparency in takeovers. The amendments require an investor purchasing a majority stake in a publicly traded company to offer to buy out minority shareholders. In addition, a company targeted in a takeover is prohibited from triggering certain defensive actions or attempting to frustrate a bid and would have to provide full and identical information to all shareholders on the takeover bid. A complete new securities market law, however, is now on its way. The Securities Market Act will bring regulations in line with EU and international standards, and is scheduled to come into force on 1 July 2001.

The small Estonian, Latvian and Lithuanian stock exchanges realised that regional co-operation would be the best way for them to attract capital. The first concrete step occurred in July 1999 when the TSE and the Riga Stock Exchange began sharing real-time information on trading. At the beginning of 2000 the Estonian, Latvian and Lithuanian stock exchanges launched the Baltic list, intended to package and market shares in the 15 largest and most widely traded Baltic companies. In May 2000 the TSE signed a letter of intent to join NOREX, the alliance of Scandinavian stock exchanges, as a fully-fledged member, although the exact timetable remains unclear. In order to join, legislation in Latvia and Lithuania must be changed. At present, the alliance is only between Sweden and Denmark, but Norwegian and Icelandic stock exchanges plan to join in 2001.

At the end of February 2001 the TSE announced “strategic cooperation” with the Helsinki Stock Exchange (HEX), meaning that the HEX would become a major shareholder in the TSE. The cooperation will be based on HEX’s offer to acquire over 50 per cent ownership in TSE, which will be achieved through purchases of existing shares as well as subscription of new shares in a directed offering. The directed issue was decided at the Annual Grand Meeting (AGM) of TSE on 21 March 2001.

Investment Funds

Fifteen open-ended investment funds currently exist in Estonia, representing over EEK 1,475 million (over US$ 87 million) assets under management. More than 40 per cent of these assets are contained in one fund, the Hansa Money Market Fund. Other funds have a variety of different investment objectives ranging from concentration in Russian equities to Estonian fixed income securities and Estonian private equity. The investment funds are governed by the Investment Fund Act, which was passed in June 1997 and is based on an EU directive. Future amendments will also introduce close-ended contractual funds and code of conduct rules for management companies.

Pension funds

In response to the build-up of pension liabilities, the authorities are moving from the pay-as-you-go pension system to a three-tier partially funded scheme. The first tier became operational in January 1999 and is financed by 20 percentage points of the 33 per cent social tax (the other 13 percentage points are designated for health care). The third tier (introduced in July 1998) consists of voluntary contributions administered by private pension funds and insurance companies. The fully funded second tier will offer additional pension coverage financed by individual contributions and the collection of contributions will start in January 2002.

The introduction of private pension funds, created under the pension reforms based on the Pension Funds Act that entered into force from August 1998 started slowly. Initial volumes were not remarkable, probably because of low incomes, relatively high inflation expectations and low understanding of the product. The minimal capital requirement for the manager of a pension fund is EEK 12 million. Hansa Pension Fund, managed by Hansa Asset Management, which received its licence in early 1999, was the only private pension fund until Ühispank Asset Management, the asset-management arm of Ühispank, received a pension-fund licence on 17 November 2000 and started operations soon after. At present, the volume of Hansa Pension Fund is EEK 12 million and the volume of Ühispank Pension Fund is EEK 6 million. In the first half of 2001 Sampo Pension Fund will be established as the third private pension fund (see *Banking sector* above).

Insurance

While the Estonian insurance market is small, seven non-life and six life insurance companies operate, all privately owned with a large foreign presence in most of them. The insurance market went through a similar consolidation process in 1999 to that of the banking sector in 1998. The market is dominated by compulsory motor vehicle third party liability insurance. Within the voluntary class of insurance the best selling are land vehicles insurance and property insurance for legal persons. The sector, particularly life insurance, is growing rapidly and Estonia’s largest banks have a clear determination to develop the insurance business as part of their financial groups. The overall life insurance market is expanding at a rate of above 40 per cent, albeit coming from a low base (life and non-life insurance together grew by 22 per cent in 2000). Sampo Pank owns Estonia’s largest non-life insurance company Eesti Kindlustus (or Sampo Kindlustus). Hansa Group holds 55 per cent of the Estonian life insurance market. Ühispank’s life insurance arm, Ühispanga Elukindlustus, which holds 16 per cent, saw premiums increase 15 times in 2000.

Leasing

Despite its fast growth, the leasing industry is still relatively small and it is reasonable to expect that the demand for leasing services will continue to grow, becoming an increasingly important source of private sector financing. Leasing is the only source of finance to small companies without strong collateral. However, leasing penetration as a percentage of GDP in Estonia is higher than in other transition countries. Hansa Capital, the leasing subsidiary of Hansapank, is the largest leasing group in CEE by portfolio size. After the take-over of Optiva, Sampo changed the name of Optiva’s leasing arm to Sampo Leasing.

EBRD business development programmes

The EBRD Baltic Business Advisory Service (BAS) Programme

The BAS Programme provides practical business advice to SMEs by implementing and managing clearly-defined, short term projects with rapid pay-back periods. It is funded by the Nordic countries' Baltic Technical Assistance Special Fund (BTASF) and by EU Phare.

The BAS Programme assists enterprises to remove barriers to growth and development, to enhance competitiveness and management effectiveness, and to prepare for EU accession.

Qualified local consultants are used to the maximum extent possible. The BAS Programme currently works with 301 Baltic consultants, compared with 55 when the Programme started in 1995. Where the assignments are beyond the capabilities of local consultants, foreign consultants are contracted and in many cases twinned with local consultants to promote knowledge transfer.

Up to 50 per cent (to a maximum of € 9,000) of the cost of each project is contributed by BAS, and the remaining cost is covered by each enterprise.

As of 31 December 2000, the BAS Programme had financed a total of 1,300 projects with 900 enterprises. Enterprise clients in total employ 98,000 and generate total revenues of € 3.6 billion. The programme now includes companies with less than 50 employees, the fastest growing business sector in terms of employment. This "micro-BAS" programme is also funded by the BTASF.

The EBRD TurnAround Management (TAM) Programme

The TAM Programme transfers management and technical know-how to enterprises in the EBRD's countries of operation, assisting these enterprises to develop the skills necessary to succeed and grow in free market economies.

The TAM Programme works directly with individual enterprises, advising each, as appropriate, on: developing management skills, business planning, restructuring, improving products and reducing operating costs, meeting EU criteria for manufacturing and production, and on the development of local and export markets.

In the course of each project, particularly in the EU accession countries, TAM additionally advises on environmental impact, optimisation of energy and materials use, and on improvement of health and safety of employees at work. TAM also advises on how to access external investments and/or loans.

Enterprises selected for TAM projects have 300 – 3,000 employees (less than 300 when turnover is more than US$ 2 million), and are engaged in manufacturing of industrial and consumer products, as well as heavy industry, food processing and transportation. The TAM Programme sends a suitably qualified Senior Industrial Advisor (SIA), with long experience at top management level in the same industry sector, to work with the enterprise's management for about 30 days spread out over 12 to 18 months. The SIA also brings in one or more specialists to deal with particular functional areas such as MIS and marketing

The impact of TAM in the Baltics is illustrated by the fact that the aggregated sales of the 164 Baltic enterprises with which TAM projects have been implemented, is US$ 3.2 billion (i.e. about US$ 20 million per enterprise on average), and 53 of these have been able to mobilise US$ 448 million of external financing (investments and loans) during or after TAM assistance.

TAM enterprises employ 132,000 people.

EBRD activities in Estonia

As at 31 December 2000, the European Bank for Reconstruction and Development (EBRD) had signed 41[1] projects in Estonia totalling € 367.3 million. Of this total, € 273.9 million was for 34 projects in the private sector and € 93.4 million for seven public sector projects.

While many of the projects classified as private sector are in the financial sector, increasingly in recent years direct financing has been provided by the EBRD to manufacturing companies. The seven public sector projects focus on water supply, airport upgrading, railway reconstruction, energy, environment and telecommunications. Estonian projects have also benefited significantly from funding under the Baltic Investment Programme.

Overview of EBRD activities and key priorities

The Bank focuses on the following main operational objectives:

- **Supporting restructuring, commercialisation, and privatisation, as well as participation by the private sector, in the infrastructure sectors, including municipal infrastructure**. The EBRD will target in particular power/heat generation, transmission and distribution of electricity, district heating and other municipal services, ports and railways. In the case of larger infrastructure-related enterprises, the Bank stands ready to provide pre-privatisation financing linked to restructuring, as well as to participate in privatisation or post-privatisation transactions alongside strategic investors. The Bank, through its projects, also aims at helping develop, test and refine regulatory frameworks, and municipal credit enhancement. Projects that strengthen the key role of Estonia in east-west trade (e.g. private sector port terminals, further commercialisation of the railways and railway concessions) will be actively pursued.
- **Transactions in the financial sector: these are focused mainly on areas in the banking sub-sector where the Bank can still have an important transition impact or additionality** (e.g. credit lines to support small and medium-sized enterprises (SMEs), regional trade facilitation), further investments in the three regional investment funds established for the Baltic states which the Bank helped establish, and transactions focused on the development of other segments of the financial sector, such as debt financing of the largest leasing companies, and private pension funds.
- **Promoting restructuring and improved corporate governance of enterprises, and SME development**. This will include direct financing of domestic enterprises in the agribusiness, industrial and service sectors, as these grow in size. The Bank will support the restructuring, particularly financial, of larger viable industrial enterprises. Co-financing with local banks as well as close coordination with the Turn Around Management Programme (TAM) will enhance transition impact.

  The Bank will continue with its strong focus on SMEs given that much of the corporate sector in Estonia falls within this category. For this purpose, the Bank will rely on the regional equity funds, the Direct Investment Facility (DIF), the Baltic Investment Programme and the EU/EBRD SME Facility channelled through the local banking sector. TAM and Business Advisory Services programmes will be further expanded.

The Bank stands ready to promote Estonia's cooperation with nearby countries, in areas such as trade, transportation, banking, environment, energy (e.g. the development of a Baltic electricity market), and cross-border investments. Environmental considerations will continue to receive particular attention in the context of Bank-financed projects.

Signed projects as at 31 December 2000

Estonian Investment Bank

The Estonian Investment Bank (EstIB) was established in 1992 to provide medium and long-term financing for small and medium-sized private companies and companies in the process of being privatised. In autumn 1992 the EBRD made an equity investment in EstIB of € 1.5 million, representing 33.3 per cent of the capital stock. The funding came from the Baltic Investment Special Fund (BISF).

In July 1994 the EBRD provided a SME credit line to EstIB of € 8 million. Half the loan came from the BISF and half from the Bank's own capital. In November 1994 the EBRD doubled its equity in EstIB when the bank underwent a capital increase. At the end of 1997 the EBRD sold its equity investment in EstIB. EstIB merged with Eesti Forekspank in 1998 and formed Optiva Pank. In 2000 the leading Finnish financial services group Sampo-Leonia acquired 93.5 per cent of Optiva Pank, which is now operating under the name AS Sampo Pank.

Energy sector emergency investment project

In December 1992 the EBRD signed a loan of € 24.7 million for urgent repairs and investments on the energy supply and demand sides. The funding has been used for priority repairs to energy supply facilities and for measures to improve supply and end-use efficiency and import facilities for petroleum products. For instance, the project has financed heavy fuel oil import facilities at Pakterminal, a gas meter station at the border with Russia, spare parts for power stations, district heating substations and heat meters, as well as boiler conversions.

1. Excluding projects funded by regional investment funds.

Tallinn Airport airfield upgrading

Tallinn Airport, the country's only international airport, has been upgraded following a US$ 14.2 million loan made by the EBRD to the State Enterprise Estonian Airports (SEEA) in March 1994. The airport was in urgent need of improvements to the existing runways and taxiways and to the lighting systems. As well as financing these vital needs, the loan was instrumental in bringing about improvements to the institutional and regulatory frameworks for the Estonian airport system.

Tallinn water and environment project

In July 1994 the EBRD made a loan of DM 44.4 million to the Tallinn Water and Sewerage Municipal Enterprise (TWSME) for a project to improve the city's existing water supply and waste-water system, to develop new groundwater well fields and to expand the waste-water treatment plant. The objectives of the programme were to improve the reliability of water-supply services and the quality of drinking water, and reduce water-borne pollution in the Gulf of Finland and the Baltic Sea.

Technical improvements and restructuring were also aimed at substantially reducing TWSME's operating and maintenance costs. To help the enterprise restructure into a self-financing, independent utility, TWSME was "twinned" with the Helsinki Waterworks, which acted as its advisor. Total project cost was DM 91.5 million, with DM 6.6 million from Finnish grants, DM 5 million from EC Phare, and a local component provided by TWSME.

Tallinn Water Limited Privatisation

In October 2000 the EBRD supported the privatisation of AS Tallinna Vesi (Tallinn Water) by re-financing its debt, making the company more attractive to international bidders. The EBRD made a corporate loan of € 22.5 million, consisting of a € 15.5 million for re-financing of the 1994 sovereign guaranteed loan and additional financing of € 7 million.

Eurovision – Estonia

Estonia was one of 15 central and eastern European countries to benefit from the extension of the Eurovision network. Each country borrowed € 0.9 million for the partial financing of one transmit-and-receive Earth station, allowing it to be linked to the Eurovision network by satellite.

Eesti Ühispank

In July 1995 the EBRD extended a credit line of DM 17 million to AS Eesti Ühispank (EUP), Estonia's second-largest bank, to provide it with medium-term funding to be used to finance SMEs. EUP has offices throughout Estonia.

In July 1997 the EBRD extended a housing financing facility of € 6.1 million to EUP. In April 1998 the EBRD provided EUP with a DM 40 million loan for on-lending to Estonian private sector companies. In summer 1998 Eesti Ühispank merged with Tallinna Pank. In August 2000 the EBRD signed a loan of € 3.0 million to EUP for SME financing, under a facility established with co-financing from the Baltic Investment Special Fund.

Eesti Ühispank (formerly Tallinna Pank)

In June 1996 the EBRD extended a DM 12 million credit line to AS Tallinna Pank, the fourth-largest bank in Estonia, to provide private sector enterprises with new medium-term financing. In April 1997 the EBRD made a subordinated loan of DM 5 million to Tallinna Pank to increase its capital base, allowing the continued expansion of its business activities, including its private sector loan portfolio. This was extended to DM 15 million in January 1998. In summer 1998 Tallinna Pank merged with Eesti Ühispank.

Sampo Pank (formerly Optiva Pank, formerly Eesti Forekspank)

In July 1996 the EBRD extended a DM 12 million credit line to AS Eesti Forekspank (EFP) to provide Estonian private sector enterprises with new medium-term financing. The EBRD extended another DM 4 million subordinated loan to EFP in March 1997. EFP merged with the Estonian Investment Bank in 1998 and became Optiva Pank. In 2000 the leading Finnish financial services group Sampo-Leonia acquired 93.5 per cent of the bank, which is now operating under the name AS Sampo Pank.

In December 2000 the EBRD extended a € 10 million revolving credit line to Optiva Pank for the promotion of SMEs. The proceeds of the six-year loan will be used by the bank to provide micro loans (up to € 30,000) and small loans (up to € 150,000) to qualifying entrepreneurs and SMEs. Optiva Pank is the first Estonian bank to receive financing provided under the SME Finance Facility, which was established by the EBRD and the European Commission in April 1999.

Small municipalities environment programme

Limited sources of infrastructure investment financing for small municipalities in Estonia has led to the deterioration of the water-supply infrastructure, creating health risks and pollution. As individual municipal projects in smaller Estonian towns were not large enough to warrant a direct loan from the EBRD, several projects were consolidated into a project of € 46.0 million, of which the EBRD provided € 10.23 million.

Hansapank

The EBRD has provided Hansapank, the leading financial institution in the Baltic states, with two credit lines of DM 17 million and DM 12 million and a housing finance facility of DM 12 million. The latter, signed in March 1996, was the first facility of its kind undertaken by the EBRD in eastern Europe and the first mortgage loan facility in the Estonian market. In May 1995 a trade facilitation project was signed.

In May 1997 the EBRD made a subordinated loan of DM 15 million to Hansapank to increase its capital base and support its expansion. The subordinated loan was increased by DM 15 million in January 1998. In November 1998 the EBRD arranged a DM 150 million senior bank-to-bank syndicated loan to Hansapank, of which it contributed DM 50 million.

In summer 1998 Hansapank merged with Eesti Hoiupank to create the largest banking group in the Baltic states under the name Hansapank. In September 1998, the EBRD made a convertible syndicated loan of DM 10 million and has now converted the loan, together with an earlier DM 25 million subordinated loan to Eesti Hoiupank, into share capital of Hansapank. The EBRD now owns 9.7 per cent of the new bank. In July 2000 the EBRD signed a loan of € 5 million to Hansapank for SME financing, under a facility established with cofinancing from the Baltic Investment Fund.

Hansapank (formerly Eesti Hoiupank)

Eesti Hoiupank (EHP) was one of the largest banks in Estonia. In June 1995 the EBRD extended a credit line of DM 13 million (half of it financed by BISF) and an equity investment of DM 3.5 million, with the following objectives:

- privatisation of EHP by diluting the shareholding of Eesti Pank, the Central Bank of Estonia, and institution building at EHP through the provision of credit without sovereign guarantee;
- provision of funding to the private sector, particularly to SMEs;
- opening up the international banking markets to EHP.

In January 1997 the EBRD also extended to EHP a housing financing facility of DM 15 million and in December 1997 a subordinated loan of DM 25 million. In summer 1998 Eesti Hoiupank merged with Hansapank to create the largest banking group in the Baltic states.

Imavere Sawmill expansion

In December 1997 the EBRD extended a loan of DM 13.8 million to AS Imavere Saeveski to create Estonia's most modern sawmill. The loan has been used to expand the sawmill's production capacity and to allow it to process the full range of log sizes of coniferous species available in Estonia. The loan also allows the company to increase the flexibility of its production, and thus to better serve the export markets by offering products with a variety of specifications. The proceeds were used to complete kilns for drying the sawmill production. With a total cost of DM 35.8 million, the project was co-financed by Hansapank and EstIB.

This was followed in December 1999 by an EBRD loan of DM 10.0 million to support further technical development of the company, allowing it to also extend production to higher value products.

AS Norma

In June 1998 the EBRD provided AS Norma, a car safety belt manufacturer, with a DM 13 million loan. The proceeds of the EBRD's loan have been used to finance the modernisation of Norma's equipment and technology, and the renovation of its facilities. Founded 107 years ago, Norma began the production of car safety belts in the early 1970s, and is the main supplier to automobile manufacturers in the CIS. It maintains a leading position in the CIS automobile market as a safety belt manufacturer by supplying 76.4 per cent of the safety belts required by the Russian automotive industry.

Baltex 2000/Qualitex

In December 1998 the EBRD approved DM 5 million equity investment in Baltex 2000 and a senior loan to its fully owned Estonian subsidiary Qualitex (formerly Lotus Colours 2000). The loan facility consists of a loan to the company's subsidiary totalling DM 12 million (€ 8.7 million). The operation aimed at enabling Baltex to complete the modernisation of the woven cotton fabric mill in Tallinn and to build a knitting/finishing mill at its subsidiary Qualitex in Sindi, Estonia.

Estonian Railways

A loan of € 15.0 million was extended by the EBRD to Estonian Railways in April 1999 to develop a modern railway infrastructure for freight and a safer environment for Estonia's railway workers. One of the main objectives of the project was to create the conditions for the successful privatisation of the country's rail freight operations. The project is improving rail facilities, which in turn will protect international freight revenues and meet the growing demand for rail transit services in Estonia. The loan complements financing that is already being provided by the European Investment Bank for track renewal and a grant from EU Phare for rail infrastructure development.

Tallinn Airport passenger terminal reconstruction

In April 1999 the EBRD provided a € 7.6 million loan to help Tallinn Airport modernise its passenger terminal building. The loan has a 14-year term. The project was part of a comprehensive programme to provide Estonia with a modern, efficient and commercially oriented airport. The modernisation of the terminal building aimed at improving passenger comfort, providing up-to-building aimed at improving passenger comfort, providing up-to-date facilities required by the various airlines serving Tallinn, and increasing capacity to handle growth in traffic. In addition, the project aimed to enable the airport to comply with various European Union and international regulations.

Hansa Capital

A syndicated loan of € 40 million was provided in June 1999 to Hansa Capital, a leading regional financial institution based in Estonia. The loan was jointly arranged by the EBRD, Commerzbank AG and Deutsche Bank AG. Under the financing, the EBRD is providing € 13.3 million for its own account, and a group of commercial banks are providing € 26.7 million.

The loan will ensure the stable development of Hansa Capital and its leading position in the Baltic leasing market. Leasing provides an additional means of financing for SMEs and helps to strengthen private sector development in the Baltic region. Hansa Capital offers its clients both financial and operating leases on commercial vehicles, property, industrial equipment, cars and agricultural machinery.

Baltic Food Holding

In June 2000 the EBRD provided financing of € 12.1 million to Baltic Food Holding Eesti OY, one of the largest pan-Baltic operators of supermarkets and food wholesale. The EBRD's financing consisted of a € 5.5 million equity investment and a loan of € 6.6 million. The financing will be used for the expansion of the company's supermarket operation and associated wholesale and distribution activities in Estonia, Latvia and Lithuania.

Baltic states regional equity funds

Baltic Investment Fund

The Baltic Investment Fund (BIF) was established to undertake equity and equity-related investments primarily in medium-sized enterprises in Estonia, Latvia and Lithuania. The EBRD's commitment was for up to US$ 6.25 million, with co-financing from the Baltic Investment Special Fund of US$ 6.25 million, and for a total Fund size of US$ 25 million. The purpose of the BIF is to support the growth of attractive privately owned businesses in the Baltics. A second fund with similar objectives (BIF III LP) was signed in November 2000 with an EBRD contribution of € 8 million, a € 5 million contribution from the Baltic Investment Special Fund, and for a total Fund size of € 40 million.

Baltic Post-Privatisation Fund (PPF)

The € 31 million Baltic Post-Privatisation Fund was launched in late 1996, initially as separate country funds for Lithuania and for Latvia, and combined in mid 1998 to form a regional Baltic fund targeting private equity investments in Lithuania, Latvia and Estonia. The Fund's committed capital comprises € 30 million from the EBRD, in the form of a managed account, and € 1 million as a co-investment facility committed by the Fund manager.

The Fund is managed by Scandinavian Baltic Development Ltd, with offices in Vilnius, Riga and Tallinn. Suprema is the Fund's local advisor. The Fund targets medium-sized manufacturing and service companies operating in the Baltic States that may require turnaround and restructuring, that may have difficulty in attracting long-term capital, and that offer attractive investment potential.

The Fund manager, supported by technical assistance funding provided by EU Phare, works with each investee company to restructure and expand the business. This is being achieved by strengthening corporate governance, improving cost control, and increasing sales and profitability. EU Phare also provides technical assistance funding to finance the Fund manager's "due diligence" on target investee companies.

Baltic Small Equity Fund

The Fund was set up in late 1997 to invest in SMEs in the three Baltic states, and its operation is based on a partnership between the Fund and the investee companies. The Fund takes a minority stake in the investee companies with investments in the range of US$ 25,000 – 400,000.

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Signed projects as at 31 December 2000 (in € million), exchange rates as at 31 December 2000

Operation name	Sector	Total cost	EBRD Debt	EBRD Equity	EBRD Total
Private sector					
Baltic Food Holding	Agribusiness	57.4	6.6	5.5	12.1
Estonian Investment Bank -capital increase	Finance	4.5	0	1.5	1.5
Optiva Pank (formerly Estonian Investment Bank) credit loan	Finance	8.0	4.0	0	4.0
Optiva Pank SME loan	Finance	10.0	10.0	0	10.0
Optiva Pank (formerly Eesti Forekspank)	Finance	6.1	6.1	0	6.1
Optiva Pank (formerly Eesti Forekspank) subordinated loan	Finance	2.0	2.0	0	2.0
Eesti Uhispank SME Facility	Finance	11.0	3.0	0	3.0
Eesti Uhispank credit line	Finance	8.7	8.7	0	8.7
Eesti Uhispank	Finance	6.1	4.3	0	4.3
Eesti Uhispank housing loan	Finance	6.1	6.1	0	6.1
Eesti Uhispank – increase in subordinated loan	Finance	5.1	5.1	0	5.1
Eesti Uhispank long-term credit line	Finance	20.5	16.6	0	16.6
Eesti Uhispank (formerly Tallinna Pank) subordinated loan	Finance	2.6	2.6	0	2.6
Hansapank SME Facility	Finance	10.0	5.0	0	5.0
Hansapank credit line	Finance	8.8	2.6	0	2.6
Hansapank (formerly Eesti Hoiupank)	Finance	8.2	2.1	1.5	3.6
Hansapank (formerly Eesti Hoiupank)equity	Finance	1.4	0	1.9	1.9
Hansapank housing loan	Finance	6.1	6.1	0	6.1
Hansapank (formerly Eesti Hoiupank) housing loan	Finance	7.7	7.7	0	7.7
Hansapank subordinated loan	Finance	7.7	7.7	0	7.7
Hansapank (formerly Eesti Hoiupank) subordinated loan	Finance	25.6	12.8	12.7	25.5
Hansapank – increase in subordinated loan	Finance	7.7	7.7	0	7.7
Hansapank convertible subordinated loan	Finance	10.5	5.1	5.1	10.2
Hansapank syndicated loan	Finance	76.7	25.6	0	25.6
Hansapank credit line	Finance	6.1	0.3	0	0.3
PPF – Baltic PPF – Tallegg	Finance	2.9	0	2.8	2.8
PPF – Baltic PPF – Tallegg	Finance	0.1	0	0.1	0.1
PPF – Baltic PPF – Microlink	Finance	1.9	0	1.8	1.8
Hansa Capital syndicated leasing finance facility	Finance	40.0	13.3	0	13.3
Maritime Development	Finance	45.6	20.4	0	20.4
Eesti Maapank equity investment	Finance	2.6	0	1.5	1.5
IO Fund – Bunim – Welding	Manufacturing	0.5	0.2	0.3	0.5
AS Norma	Manufacturing	10.2	4.1	0	4.1
Baltex 2000/Qualitex	Textiles	27.0	6.1	2.6	8.7
Tallinn Water Limited Privatisation	Municipal infrastructure	22.5	22.5	0	22.5
Imavere Sawmill Expansion I	Wood processing	18.3	7.1	0	7.1
Imavere Sawmill Expansion II	Wood processing	7.4	5.1	0	5.1
Private sector total		***503.6***	***236.6***	***37.3***	***273.9***
Public Sector					
Eurovision	Media	0.9	0.9	0	0.9
Energy sector emergency investment	Energy	57.7	24.7	0	24.7
Tallinn Airport upgrading	Transport	14.2	12.3	0	12.3
Tallinn Airport passenger terminal reconstruction	Transport	23.1	7.6	0	7.6
Estonia Railways	Transport	73.1	15.0	0	15.0
Tallinn water and environment project	Municipal infrastructure	85.3	22.7	0	22.7
Small municipalities environment project	Municipal infrastructure	46.0	10.2	0	10.2
Public sector total		***300.3***	***93.4***	***0***	***93.4***
Total		**803.9**	**330.0**	**37.3**	**367.3**
of which private					75%
of which public					25%